Supreme Court, U.S.
FILED
98 1967 JUN 7 1999
OFFICE OF THE CLERK

No.

IN THE

Supreme Court of the United States

KENNETH WITHROW and FRANKLIN WITHROW,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

PETITION FOR A WRIT OF CERTIORARI

JOHN T. LONGINO
Attorney for Petitioners
P.O. Box 310
Ellijay, Georgia 30540
(706) 695-7780

153207

Counsel Press LLC
FORMERLY LUTZ APPELLATE SERVICES
(800) 274-3321 • (800) 359-6859

6788

QUESTIONS PRESENTED

(1) What causes a property owner to **lose** standing to contest a forfeiture?

[e.g., whether a person who purchases vacant land with his own money, who builds a home on that land with his own money, his own materials, and his own labor, who then turns the maintenance of the property (which has a stipulated value of $121,000) over to his grown son but maintains some limited supervision in his old age, and who owns the property for twelve years without incident, loses standing to contest forfeiture?]

(2) Does the possession of 22.9 ounces of undried marijuana plants grown and harvested elsewhere authorize a forfeiture of property under the statute?

(3) If so, is such a forfeiture barred under the Excessive Fines Clause of the Eighth Amendment to the United States Constitution?

TABLE OF CONTENTS

Page

Questions Presented i

Table of Contents ii

Table of Cited Authorities iv

Table of Appendices v

Opinions Below 1

Statement of Jurisdiction 1

Constitutional and Statutory Provisions Involved . 2

Statement of the Case 3

A. Standing 4

B. Forfeiture 6

C. Excessive Fine 7

Reasons for Granting the Writ 8

I. The Petition For A Writ Of Certiorari Should Be Granted Because The Decisions Of The District Court And The Court Of Appeals Conflict With This Court's Decisions Regarding The Standards To Be Applied In Determining Whether A Forfeiture Constitutes And Excessive Fine. 8

Contents

Page

II. The Petition For A Writ Of Certiorari Should Be Granted Because The Decisions Of The District Court And The Court Of Appeals Conflict With This Court's Decisions Regarding Whether Forfeiture Is Authorized Under The Statute. 9

III. The Petition For A Writ Of Certiorari Should be Granted Because The Decisions Of The District Court And The Court Of Appeals Conflict With The United States Constitution, Article III And The Court Of Appeals' Other Decisions Regarding What Constitutes Standing To Assert An Innocent Owner Defense To Forfeiture. 10

Conclusion 11

TABLE OF CITED AUTHORITIES

Page

Cases:

Austin v. United States, 509 U.S. 602 (1993) 8

United States v. Bajakajian, 524 U.S. 321, 118 S. Ct. 2028 (1998) 9, 10

United States v. Palmetto Drive, 928 F.2d 373 (11th Cir. (Fla.) 1991) 10

Statutes:

21 U.S.C. § 881(a)(7) 2, 8

28 U.S.C. § 1254 1

United States Constitution:

Article III 10

Eighth Amendment ..... i, 2, 8

TABLE OF APPENDICES

Page

Appendix A — Judgment Of The United States Court Of Appeals For The Eleventh Circuit Dated And Filed June 16, 1997 ..... 1a

Appendix B — Order Of The United States District For The Northern District Of Georgia, Rome Division Dated And Filed September 20, 1996 . 3a

Appendix C — Judgment Of The United States District Court For The Northern District Of Georgia, Rome Division Dated, Filed And Entered September 20, 1996 ..... 18a

Appendix D — Order Of The United States District Court For The Northern District Of Georgia, Rome Division Dated June 5, 1996 And Filed June 6, 1996 ..... 20a

Appendix E — Opinion Of The United States Court Of Appeals For The Eleventh Circuit Dated And Filed March 10, 1999 ..... 50a

Petitioners, Kenneth and Franklin Withrow, respectfully request that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the Eleventh Circuit in this case.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Eleventh Circuit is unreported and is reproduced as Appendix A. The opinion of the district court is also unpublished and is reproduced as Appendix B.

STATEMENT OF JURISDICTION

The judgment sought to be reviewed in this Court was entered by the United States Circuit Court of Appeals for the Eleventh Circuit on June 16, 1997.

A timely motion for reconsideration was filed; a decision of the Court of Appeals denying in part and granting in part the Motion for Reconsideration was entered on March 10, 1999; the matters addressed by the Court of Appeals in the remand to the United States District Court for the Northern District of Georgia were not raised by Petitioners, are not involved in the appeal, and review of the issue on remand will not be sought by these Petitioners.

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Constitutional and Statutory Provisions involved are the Eighth Amendment to the United States Constitution in its excessive fines clause and 21 U.S.C. § 881(a)(7). The relevant portions are as follows:

21 U.S.C. § 881(a)(7):

> All real property, including any right, title, and interest (including any leasehold interest) in the whole of any lot or tract of land and any appurtenances or improvements, which is used, or intended to be used, in any manner or part, to commit, or to facilitate the commission of, a violation of this subchapter punishable by more than one year's imprisonment, except that no property shall be forfeited under this paragraph, to the extent of an interest of an owner, by reason of any act or omission established by that owner to have been committed or omitted without the knowledge or consent of that owner.

Eighth Amendment:

> Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishment inflicted.

STATEMENT OF THE CASE

Petitioners are father and son. In 1981 the father (Kenneth Withrow — hereafter Kenneth) cashed in a Certificate of Deposit at the Bank of Ellijay in the principal amount of $15,000 and used said sum to purchase, in his name, 5 acres of land in Murray County, Georgia. Kenneth owned other land, including timber land, and owned a sawmill. Kenneth cut timber, sawed it in his sawmill and, together with the labor of his two grown sons (Franklin and Johnny) constructed the home with their own materials and labor. Kenneth lives and at all times lived approximately 15 miles away from the subject property and at all times his son (petitioner) Franklin lived on the subject property. For the ensuing 12 years, the arrangement continued, with Kenneth paying some of the taxes and maintenance and Franklin paying some, in an informal, familial manner. In the early summer of 1993 United States Forest Service Agents observed marijuana patches growing approximately a mile from the subject property. They staked out and hid a camera near the marijuana patches which were clearly visible from the State Highway 52 in Murray County, and which were adjacent to roadside blackberry bushes. In late July 1993, while blackberry picking, Franklin discovered the patches near the highway. On September 2, 1993 Franklin returned to the patches, and was caught on film pulling up one or more plants. Then on September 8, 1993 the property was raided by the State Police and other state law enforcement agencies. They found a marijuana plant hanging from the head of a deer that was mounted in the living room and two small plants in the yard. Franklin pled guilty to the offense of simple possession of 9 ounces of marijuana and was sentenced to jail. Under Georgia law,

no fine is allowed for the offense. Kenneth was not accused of any wrongdoing whatsoever.

The United States Government then filed a petition in the United States District Court for the Northern District of Georgia, Rome Division, seeking forfeiture of the subject 5 acres and home. Prior to trial the United States Government and the Petitioners herein stipulated that the value of the property with improvements was $121,000. At trial, the trial judge determined that the weight of the undried contraband, including roots, stems, etc. was 22.9 ounces (the State Charge being that the usable weight of the marijuana was 9.0 ounces), that the value of the contraband was $3,500 — or nearly $400 per ounce — and then ordered forfeiture of the subject real property.

The Order of the United States District Court is erroneous for many reasons requiring a lengthy analysis as set forth below.

A. Standing

While it was disputed whether Franklin's ex-wife contributed 20% of the initial purchase price (she had no records to establish her claim while Kenneth had complete records showing the source of all funds used in the purchase), it was undisputed that the vast majority — if not all — of the funds and materials for the purchase of the land and the construction of the home came from Kenneth: the $15,000 purchase price came from Kenneth Withrow's Certificate of Deposit; Kenneth Withrow still had, fifteen years later at trial, original checks and invoices for materials he purchased for the construction of the home, such as pipe

and wiring, totaling $6,100.53, as expressly included by the trial court in its findings of fact. Franklin's ex-wife even claimed that the purchase was a loan from Kenneth, but had no loan documents, no loan payments, no witnesses to the loan agreement. The trial court went even further in its findings of fact stating that "Kenneth Withrow provided funds for the purchase of the defendant property and provided some labor and materials for the construction of the house. . . ." It was undisputed that Kenneth was the only title holder of record for the entire time since the purchase and was billed for and responsible for all taxes on the subject property. It was undisputed that as late as three months prior to the police raid, Franklin told a prospective renter that all decisions regarding the use of the subject property were to be made by the owner, his father Kenneth. It was undisputed that Franklin and Kenneth had been in a dispute concerning the maintenance of the siding on the home — siding that Kenneth had personally grown, cut, planed, dried, and installed on the subject premises — that Kenneth told Franklin to do it Kenneth's way or move out, and that Franklin relented and performed the maintenance as his father demanded. It was undisputed that Franklin, 45 years old at the time of trial, had no prior criminal record other than the one guilty plea for marijuana possession arising out of this matter. It was undisputed that Kenneth, 65 at the time of trial, had no knowledge of marijuana being on the subject property and that, if he had standing to contest the forfeiture, he would be an innocent owner able to invoke the innocent owner exception to forfeiture. Yet the trial court found that Kenneth did not have standing to contest the forfeiture as an innocent owner, finding instead that Kenneth had exercised no dominion or control over the subject property. It found that "people engaged in drug trafficking

often attempt to disguise their interests in property by placing title in someone else's name" even though there is not and never has been any claim of any illegal activity on the subject property by Franklin or Kenneth Withrow in the eleven years prior to the incident that gave rise to the forfeiture action. It is beyond implausible that, in 1981 in anticipation of finding a marijuana patch eleven years later, that Franklin would place the title to "his" home in his father's name. The trial court then connected the titling of property in a strawman's name to avoid seizure for trafficking with the evidence that Franklin had "lost" a home in a divorce many years earlier as if — assuming arguendo that Franklin had wanted his father to own the property to avoid losing it in a divorce — that such intent constitutes grounds for establishing a strawman claim related to drug trafficking.

B. Forfeiture

The trial court held, inconsistently, that Franklin Withrow was seen on property a mile distant from his residence harvesting marijuana, that the marijuana was found on the subject property when the raid occurred, and that "growing marijuana is an activity sufficient to subject the property on which cultivation occurs to civil forfeiture under section 881(a)(7)." It was not disputed that the seized marijuana was not grown on the subject property, but on other property a mile away. Further, the express testimony of the only person other than Franklin to testify on the issue of manufacturing (Franklin having testified that he had the marijuana for his own personal use — less than a year's supply for one person) testified for the Government: (a) that in all manufacturing operations there are records of

sales and other financial records located; and (b) but that in this instance there were no such records located. Thus the concept that Franklin was using a mounted deer head to dry a single marijuana plant grown a mile away in plain view of a State Highway as manufacturing marijuana is beyond incredible. This is a case of a person who simply possessed a small amount of marijuana for his own personal use on property bought, paid for, built by and controlled by his father.

C. Excessive Fine

The parties stipulated that the property sought to be forfeited was valued at $121,000. The trial court had evidence before it at trial — all from law enforcement officers — that the value of the marijuana seized was, variously: (a) essentially worthless as a male plant; (b) worth $500; or (c) worth $3,500 if it had been a female plant (there was no evidence that it was a female plant, only that if it had been, the valuation would have been such). The trial court chose to accept the highest valuation of $3,500. The crime for which Franklin Withrow is guilty is simple possession of 9 ounces of marijuana. Under applicable Georgia law, no fine at all is allowed for the offense.

REASONS FOR GRANTING THE WRIT

I.

THE PETITION FOR A WRIT OF CERTIORARI SHOULD BE GRANTED BECAUSE THE DECISIONS OF THE DISTRICT COURT AND THE COURT OF APPEALS CONFLICT WITH THIS COURT'S DECISIONS REGARDING THE STANDARDS TO BE APPLIED IN DETERMINING WHETHER A FORFEITURE CONSTITUTES AND EXCESSIVE FINE.

The forfeiture sought, under section 881(a)(7), is subject to review for excessiveness under the excessive fines clause of the Eighth Amendment. *Austin v. United States*, 509 U.S. 602 (1993). The forfeiture of real property worth $121,000 for the presence on the property of 22.9 ounces (the approximate weight of two cartons of cigarettes) of undried marijuana, marijuana stalks, marijuana roots, etc. valued, at the most at $3,500 (or 2% of the property value) is clearly excessive.

> The touchstone of the constitutional inquiry under the Excessive Fines Clause is the principle of proportionality: The amount of the forfeiture must bear some relationship to the gravity of the offense that it is designed to punish. (Cits) It is in the light of the extensive criminal activities which petitioner apparently conducted . . . that the question whether the forfeiture was "excessive" must be considered. * * * [A] punitive forfeiture violates the Excessive Fines

> Clause if it is grossly disproportional to the gravity of a defendant's offense. * * * Whatever his other vices, [the Claimant] does not fit into the class of persons for whom the statute was principally designed: He is not a money launderer, a drug trafficker, or a tax evader.

United States v. Bajakajian, 524 U.S. 321, 118 S. Ct. 2028 (1998).

II.

THE PETITION FOR A WRIT OF CERTIORARI SHOULD BE GRANTED BECAUSE THE DECISIONS OF THE DISTRICT COURT AND THE COURT OF APPEALS CONFLICT WITH THIS COURT'S DECISIONS REGARDING WHETHER FORFEITURE IS AUTHORIZED UNDER THE STATUTE.

> "And under the Sentencing Guidelines, **the maximum sentence that could have been imposed on respondent** was six months, while the maximum fine was $5,000."

United States v. Bajakajian (emphasis added) (decided by this Court after rejection by the Court of Appeals of the Excessive Fines claim of Petitioners).

The trial court implicitly found that the Sentencing Guidelines would tend to make forfeiture inapplicable under the statute, but expressly found that the Sentencing Guidelines were irrelevant and "even were the sentencing guidelines relevant to this issue, the Court concludes that

the question [Excessive Fines] should be answered by reference to the **possible sentences assignable to the offense** under the guidelines, **rather than the sentencing range assignable to the instant claimant**." (emphasis added). As noted above, neither the trial court not the Court of Appeals had the benefit of this Court's decision in *Bajakajian* when those determinations were made.

III.

THE PETITION FOR A WRIT OF CERTIORARI SHOULD BE GRANTED BECAUSE THE DECISIONS OF THE DISTRICT COURT AND THE COURT OF APPEALS CONFLICT WITH THE UNITED STATES CONSTITUTION, ARTICLE III AND THE COURT OF APPEALS' OTHER DECISIONS REGARDING WHAT CONSTITUTES STANDING TO ASSERT AN INNOCENT OWNER DEFENSE TO FORFEITURE.

The determination that an elderly man who pays for the purchase of land, pays for the material for the construction of a home, provides some of the labor for the construction of a home, oversees and dictates maintenance of the home, is acknowledged openly and publicly by the resident grown son as the owner of the home, is the record title owner of the home, is the record tax payer for the property, does not have standing to contest forfeiture of the property is so violative of law and policy that it must be reviewed. In *United States v. Palmetto Drive*, 928 F.2d 373 (11th Cir. (Fla.) 1991) the Court of Appeals held that in such cases standing to assert an innocent owner defense applies. Standing is a threshold issue established as a requirement under Article III of the United States Constitution. Under applicable law, the uncontroverted facts set forth above establish standing.

CONCLUSION

Kenneth Withrow did all that could be done to control his land and building that he bought paid for, and built a dozen years earlier with his own money. His son, Franklin, lived on the property. Franklin found a patch of marijuana growing along the roadside of a state highway a mile from the property and took some home to dry. His removal of the marijuana from the roadside was captured on videotape and the property was raided. Found was 22.9 ounces of undried marijuana, stems, roots, and leaves with a value of no more than 2% of the value of the property sought to be forfeited. The accused, Franklin Withrow, was not subject to a penalty of more than one year in prison for the offense. Kenneth Withrow has standing as an innocent owner to contest the forfeiture. For all of the foregoing reasons, the Writ of Certiorari should be granted.

Respectfully submitted,

JOHN T. LONGINO
Attorney for Petitioners
P.O. Box 310
Ellijay, Georgia 30540
(706) 695-7780

APPENDIX

APPENDIX A — JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT DATED AND FILED JUNE 16, 1997

United States Court of Appeals
For the Eleventh Circuit

No. 96-9237
Non-Argument Calendar

D.C. Docket No. 4:93-CV-335

UNITED STATES OF AMERICA,

Plaintiff-Appellee,

versus

ROUTE 7, BOX 7091, CHATTSWORTH, GEORGIA, and all appurtenances thereon, being approximately five acres of land lot 209 in the 26th district and 2nd section of Murray County,

Defendant,

KENNETH G. WITHROW, clm,
FRANKLIN WITHROW, clm,,

Claimants-Appellants.

Appeal from the United States District Court
for the Northern District of Georgia

Before TJOFLAT, BIRCH and CARNES, Circuit Judges.

Appendix A

JUDGMENT

This cause came to be heard on the transcript of the record from the United States District Court for the Northern District of Georgia, and was taken under submission by the Court upon the record and briefs on file, pursuant to Eleventh Circuit Rule 34-3;

UPON CONSIDERATION WHEREOF, it is now hereby ordered and adjudged by this Court that the judgment of the said District Court in this cause be and the same is hereby AFFIRMED;

It is further ordered that claimants-appellants pay plaintiff-appellee the costs on appeal to be taxed by the Clerk of this Court.

Entered: June 16, 1997
For the Court: Miguel J. Cortez, Clerk

By: s/ Matt Davidson
Deputy Clerk

ISSUED AS MANDATE: MAR 18 1999

APPENDIX B — ORDER OF THE UNITED STATES DISTRICT FOR THE NORTHERN DISTRICT OF GEORGIA, ROME DIVISION DATED AND FILED SEPTEMBER 20, 1996

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ROME DIVISION

CIVIL ACTION
4:93-cv-335-HLM

United States of America,

Plaintiff,

v.

Route 7, Box 7091, Chatsworth, Georgia,

Defendant,

v.

Kenneth G. Withrow,

Claimant,

Franklin Withrow,

Claimant.

Appendix B

ORDER

This civil forfeiture action is before the Court (1) on Claimants' Motion for Reconsideration and (2) for further Findings of Fact and Conclusions of Law.

In the instant case, Plaintiff contends that the defendant real property was used by Claimant Franklin Withrow to facilitate the manufacture of marijuana and that the defendant property is, therefore, subject to forfeiture under the provisions of 21 U.S.C. § 881(a)(7). On February 12, the Court held a non-jury trial to determine whether the statutory requirements of 21 U.S.C. § 881(a)(7) had been met. After receipt of the parties' proposed findings and conclusions, the Court so found. The Court, however, did not order the defendant property forfeited because the parties had reserved a constitutional issue for a second hearing in the event the Court found forfeiture appropriate under the statute.

That issue is Claimants' contention that forfeiting the defendant property is an "excessive fine" prohibited by the Constitution. On September 11, 1996 the Court heard evidence pertaining to this issue. The matter has been briefed and is ready for disposition. Also before the Court is Claimants' Motion for Reconsideration of the Court's initial Findings of Fact and Conclusions of Law.[1]

---

1. In its initial Findings and Conclusions, the Court inadvertently noted that the parties has reserved the Claimants' "double jeopardy" claim. This was error. The issue before the Court concerns the excessive fines clause: no double jeopardy issue has been raised.

Appendix B

I. Motion for Reconsideration

1. In their Motion for Reconsideration, Claimants contend that the Government premised the instant case on the:

> manufacture — not distribution — of two plants plus up to eleven ounces from a third plant on the subject property. The Government further identified twelve plants a mile away that were allegedly being tended by Franklin Withrow . . . [which increases] the alleged manufacturing to fifteen plants. . . . There were no allegations of sale or distribution related to the forfeiture.

Motion for Reconsideration at 5-7. Claimants argue, therefore, that the offense of which Franklin Withrow is accused is not an offense subject to punishment by more than one year's imprisonment because he would not have received a sentence of more than a year if he had been convicted of manufacturing 15 marijuana plants. United States Sentencing Commission, *Guidelines Manual*, § 2D1.1(a)(3) and § 5(a) (Nov. 1992).

2. The Court concludes that Claimants are correct that 21 U.S.C. §881(a)(7) only authorizes forfeiture of real property used to commit "a violation of [28 U.S.C. 841] punishable by more than one year's imprisonment." Claimants, however, are incorrect that Claimant Franklin Withrow's behavior does not satisfy this prerequisite. This is so for several reasons.

3. First, the Court concludes that the question of whether an offense is "punishable" by imprisonment for more than a year is answered by reference to the possible punishments *authorized* by statute, rather than by the Sentencing Guidelines' treatment of a particular crime. *United States v. One Parcel of Real Property*, 960 F.2d 200, 205 (1st Cir. 1992) (implying that statutory authorization, rather than Sentencing Guidelines, is determinative: "since violations of section 841(a) are felonies punishable by more than one year in prison, *see* 21 U.S.C. § 841(b) (Supp. 1988), we also hold that growing marijuana . . . is an activity sufficient to subject the property on which cultivation occurs to civil forfeiture under section 881(a)(7)"). From 1993 to the current date, 21 U.S.C. § 841 has provided that "it shall be unlawful for any person knowingly or intentionally to manufacture . . . a controlled substance. . . . In the case of less than 50 kilograms of marihuana . . ., such person shall . . . be sentenced to a term of imprisonment of not more than 5 years." 21 U.S.C. § 841(a)(1) and (b)(1)(D). Thus, the statute provides that manufacturing even minimal amounts of marijuana is "punishable" by more than one year in prison.

4. Second, even were the Sentencing Guidelines relevant to this issue, the Court concludes that the question should be answered by reference to the possible sentences assignable to the offense under the Guidelines, rather than the sentencing range assignable to the instant Claimant — a range which is determined in part by reference to the instant Claimant's criminal history. The Sentencing Guidelines provide that a defendant convicted of manufacturing marijuana must receive at least a base offense

level of six. USSG § 2D1.1(a)(3). Six base offense level points result in sentences ranging from 0 to 18 months depending on a claimant's criminal history score. Thus, even considering the strictures of the Guidelines, manufacturing small amounts of marijuana is "punishable" by imprisonment for over a year.

5. Finally, even were the issue determined by the actual sentencing guideline range assignable to the instant Claimant Franklin Withrow, forfeiture would still be in order. The Court finds as fact that Claimant Franklin Withrow manufactured 22.9 ounces or some 649 grams of marijuana in 1993. The Court concludes that had Claimant Franklin Withrow been prosecuted for his offense in either 1993 or currently, his offense is "punishable" by more than one year in prison and remains a felony even if the Sentencing Guidelines would allow a sentence of less than one year.

6. Claimants' also move the Court to reconsider its prior findings because the Government allegedly failed to give pre-seizure notice. The Court simply notes that no evidence exists in the record indicating that the property has been seized in a constitutionally prohibited manner. *See United States v. Good Real Property*, 126 L.Ed. 2d 490 (1993).

Appendix B

II. Excessive Fines

A. Findings of Fact[2]

1. This action seeks a civil forfeiture against the real property titled in the name of Kenneth Withrow located at Route 7, Box 7091, Chatsworth, Georgia, and all buildings and appurtenances thereon, being approximately five acres of Land Lot 209 in the 26th district and 2nd section of Murray County. The defendant property sits atop Fort Mountain in Murray County and has a house and garage located on it.

2. The defendant property has a fair market value of $121,000.

3. Claimant Franklin Withrow and his wife Sharon Moore moved into the residence on the defendant real property in 1981. Sharon and Franklin Withrow lived at the residence until their separation in 1989.

4. Since the early 1980's, United States Forest Service Special Agent Jim Crowe and other Forest Service agents have received information from other law enforcement agents and civilians that Franklin Withrow was growing and selling marijuana in the Murray County area.

---

2. Some of the factual findings and legal conclusions below are identical to previously made findings and are reiterated for purposes of clarity. The Court has also made findings below that are similar, but not identical, to previously made factual findings. These findings were necessary to evaluate the excessive fines issue that has only recently come before the Court.

Appendix B

5. Since approximately 1983, Special Agent Jim Crowe and other Forest Service agents have discovered numerous patches of marijuana growing near the residence of Franklin Withrow.

6. In 1989, Sharon Moore discovered marijuana in a cooler in the garage on the defendant property and a garbage bag full of marijuana on top of plywood lying on the ceiling rafters in the unfinished addition to the house. She hid the garbage bag of marijuana and was soon confronted by Franklin Withrow who demanded to know what she had done with it. She retrieved the bag and threw it on the floor, scattering the marijuana, and then left the property for the last time.

7. From the quantity and packaging of this marijuana, the Court finds that Claimant Franklin Withrow used the defendant property to store and dry marijuana that he had previously grown. From the quantity of the marijuana, the Court also finds that Claimant Franklin Withrow did not grow this marijuana for personal use, but instead grew it with an intent to distribute.

8. In the early summer of 1993, Forest Service agents, while flying in a helicopter, observed several small patches of marijuana near the residence of Claimant Franklin Withrow.

9. Subsequently, Forest Service Special Agent Jim Crowe and other Forest Service agents set up a surveillance camera in the patches. On one occasion, when Agent Crowe and another Forest Service agent approached the marijuana

patches to service the surveillance camera, they observed a motorcycle that belonged to Franklin Withrow sitting in a trail that led to the marijuana patches. The agents observed Franklin Withrow return to his motorcycle from the area where the marijuana patches were located carrying a short-handled hoe. The agents then followed the trail of footprints and impressions left by Franklin Withrow through the woods to a freshly watered marijuana patch.

10. Claimant Franklin Withrow was cultivating these marijuana plants.

11. On August 30, 1993, Forest Service agents placed a surveillance camera near another marijuana patch located near Franklin Withrow's residence. This marijuana patch was west of the defendant real property.

12. On September 7, 1993, agents checked the surveillance film, which showed Franklin Withrow on or about September 2, 1993, fertilizing and harvesting the marijuana plants in the patch near his residence. Franklin Withrow was carrying granular fertilizer in a plastic milk jug. He was wearing a blue short-sleeved shirt with a Polo logo on the front and pink shorts.

13. Claimant Franklin Withrow was cultivating these marijuana plants.

14. On September 8, 1993, agents of the Georgia Bureau of Investigation obtained a state search warrant for Franklin Withrow's residence on the defendant real property and an arrest warrant for Franklin Withrow.

Appendix B

15. On September 8, 1993, GBI agents arrested Claimant Franklin Withrow for manufacturing marijuana and law enforcement agents executed the search warrant at Franklin Withrow's residence.

16. While searching the residence on the defendant real property, agents seized marijuana plants hanging from a mounted deer head in the living room, several layers of drying marijuana with each layer separated by sheets of newspaper on a chair in the dining room, a plastic bag of marijuana in an upstairs room in the residence, two marijuana plants growing in the yard of Franklin Withrow's residence, a large twenty-five pound box of Miracle Grow fertilizer, a plastic milk jug containing granular fertilizer, a blue short-sleeved shirt with a Polo logo and pink Pacific Coast Highway shorts. The agents also located the motorcycle that Franklin Withrow had previously used to travel to the marijuana patches east of the defendant property and the short-handled hoe that he had used to cultivate those marijuana plants.

17. The Court finds that Claimant Franklin Withrow used the house to dry, store and package marijuana that he had previously grown. Claimant Franklin Withrow also used the property to store the fertilizer, watering jug and hoe that he used to cultivate his marijuana plants. He used the property to store the vehicle he used to move to and from marijuana plants that he grew on other people's property. Claimant Withrow also used the property to grow marijuana. From the quantity of marijuana, the evidence of individual packaging of the marijuana and the fact that Claimant had grown marijuana in the past with the intent to distribute it,

the Court concludes that Claimant grew his marijuana with the intent to distribute it.

18. The marijuana seized from Claimant's house, property and his cultivated patch weighed 22.9 ounces. Its street market value was approximately $3500.00. The marijuana seized from Claimant's marijuana patches was about one-half the total marijuana seized with the remainder coming from various locations in the house and on the land of Franklin Withrow.

19. On or about November 17, 1993, Franklin Withrow was indicted by a grand jury in the Superior Court of Murray County, Georgia for unlawfully manufacturing marijuana and unlawfully possessing marijuana.

20. Claimant Franklin Withrow was incarcerated for a nine month period of time after pleading guilty to possession of marijuana.

21. Claimant Franklin Withrow resided on the defendant real property at all times since the house was built in 1981 except for his period of incarceration following his November 1993 conviction for possessing marijuana.

22. Claimant Kenneth Withrow has never exercised any dominion or control over the defendant property and is merely a record title holder.[3] Claimant Franklin Withrow,

---

3. The Court notes that in its June 6 Order, the Court found that Kenneth Withrow was the "record title owner." This was error. The Court hereby modifies that factual finding to reflect that Kenneth Withrow was the "record title holder" rather than the "record title owner."

who has always exercised ownership rights to the defendant property and held himself out to the world to be the owner of the defendant property, is the true owner of the defendant property.

B. Conclusions of Law

1. Notwithstanding the fact that Franklin Withrow limited his claim to the defendant property to a usufruct or tenancy at will, interest which is now defeated in light of the failure of Kenneth Withrow to establish standing, Franklin Withrow is in fact the true owner of the defendant property and has standing in that capacity.

2. On the basis of the aforementioned factual findings, the Court finds that Franklin Withrow used the defendant real property to facilitate his manufacture and distribution of marijuana in 1993. 21. U.S.C. § 881(a)(7).

3. "Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted." U.S. Const. amend. VIII.

4. "[T]he Excessive Fines Clause of the Eighth Amendment applies to *in rem* civil forfeiture proceedings under 21 U.S.C. § 881(a)(7)." *United States v. One Parcel Property*, 74 F.3d 1165, 1170 (11th Cir. 1996).

5. "[T]he appropriate inquiry with respect to the Excessive Fines Clause is, and is only, a proportionality test." *Id.*

6. "That is, a court must ask: Given the offense for which the owner is being punished, is the fine (imposed by civil forfeiture) excessive? While the core of proportionality review is a comparison of the severity of the fine with the seriousness of the underlying offense, it would be futile to attempt a definitive checklist of relevant factors. The relevant factors will necessarily vary from case to case." *Id.* at 1172.[4]

7. Claimant Franklin Withrow has manufactured marijuana with the intent to distribute it. He is, therefore, the most culpable of all types of drug offenders. He is not merely a "user." He is not merely a "distributor." He is the

---

4. The Court notes that the instant Complaint does not clearly identify whether this forfeiture action is premised merely upon allegations of marijuana manufacturing or whether it is also based on allegations of marijuana distribution. Prior to this point in the litigation, this distinction has made no material difference because manufacturing marijuana alone is sufficient to satisfy the requirements of 21 U.S.C. § 881(a)(7). In light of his constitutional argument, however, Claimant Franklin Withrow contends that this pleading issue is significant because distribution allegations bear on the "seriousness" of the conduct justifying forfeiture. The Court, nevertheless, concludes that this issue is of no moment. Regardless of whether "distribution" was properly pled, Claimant Franklin Withrow's intended use of his marijuana is a factual issue which is one "factor" in the totality of the circumstances which must be evaluated by the Court in determining the seriousness of his conduct. In other words, "possession with the intent to distribute" is arguably unavailable to the Government to serve as the predicate crime justifying forfeiture, but the Court's objective evaluation of the seriousness of Claimant Franklin Withrow's conduct is an entirely distinct analysis.

original link in the distribution chain without whom the illicit substance would not exist. His crime, therefore, is very "serious."[5]

8. Defendant contends, nonetheless, that his activities are not sufficiently serious to warrant forfeiting property worth $121,000 because in the instant case the amount of marijuana he manufactured was small and not particularly valuable. The Court disagrees. To begin, the Court concludes that manufacture of 22.9 ounces of marijuana was sufficiently serious, in and of itself, to warrant the instant forfeiture. *See* 21 U.S.C.A. § 841(b)(1)(D) (West Supp. 1993) ("In the case of less than 50 kilograms of marihuana . . . such person shall . . . be sentenced to a term of imprisonment [and] a fine not to exceed . . . *$250,000.*") *Austin v. United States*, 509 U.S. 602, 620 (1993) (recognizing that Congress considered drug crimes sufficiently serious to warrant forfeitures *in addition* to statutorily authorized fines: "Congress recognized that the traditional criminal sanctions of fine and imprisonment are inadequate to deter or punish the enormously profitable trade in dangerous drugs.").

9. Secondly, the obvious sophistication of Claimant Franklin Withrow's manufacturing techniques supports the inference that he was an experienced marijuana grower. This conclusion is also bolstered by the Court's finding that Claimant Franklin Withrow manufactured marijuana in

---

5. His role is also more difficult for law enforcement to detect and eliminate because, unlike most distributors, he need not buy his product from any source.

1989. Thus, he posed a greater danger to society than someone who had merely grown one batch of marijuana.[6]

10. The Court concludes, therefore, that in the instant case forfeiture of Claimant Franklin Withrow's property valued at $ 121,000, is not an excessive fine.

III. Conclusion

Accordingly, the Court **denies** Claimants' Motion for Reconsideration, **finds** for Plaintiff and against defendant real property and Claimants Kenneth and Franklin Withrow and **orders** defendant property forfeited to Plaintiff United

---

6. The Court feels compelled to make explicitly clear that it does not consider Claimant's conduct in 1989 to be properly considered as criminal activity which justifies some level of forfeiture in and of itself. In other words, the Court is not "adding" Claimant's conduct in 1989 to his conduct in 1993 to reach the conclusion that the two offenses together are sufficiently serious to justify forfeiture. Such a rationale would be improper because Claimant Franklin Withrow's conduct in 1989 was not properly pled. Instead, the 1989 incident is relevant only for what it reveals about Claimant Franklin Withrow's conduct in 1993. It is a "factor" or "circumstance" bearing on the seriousness of Claimant's conduct in 1993. Claimant's prior conduct reveals that his 1993 conduct is part of a pattern. The Court concludes, therefore, that Claimant Franklin Withrow's conduct in 1993 is actually more serious than it would have been if he was new to the world of illicit drugs and had not previously demonstrated an affinity for marijuana, a willingness to break the law, and a proficiency for doing so. The Court notes that the notion of enhancing sentences based on criminal history is based on a similar rationale.

States of America; and, directs that judgment be entered in accordance with this order.

IT IS SO ORDERED, this the 20th day of September, 1996.

s/ Harold L. Murphy
UNITED STATES DISTRICT JUDGE

APPENDIX C — JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF GEORGIA, ROME DIVISION DATED, FILED AND ENTERED SEPTEMBER 20, 1996

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ROME DIVISION

CIVIL ACTION NO.
4:93-cv-335-HLM

UNITED STATES OF AMERICA

Plaintiff

vs.

ROUTE 7, BOX 7091, CHATSWORTH GEORGIA, and all appurtenences thereon, be approximately five acres of land Lot 209 in the 26th district and 2nd section of Murray County

Defendant

JUDGMENT

This action having come before the court, Honorable Harold L. Murphy, United States District Court Judge presiding, for trial, the issues having been tried and a decision rendered, finding for the United States of America and against the defendant real property and Claimants Kenneth and Franklin Withrow, it is

Appendix C

Ordered and Adjudged that the plaintiff UNITED STATES OF AMERICA receive the forfeited property ROUTE 7, BOX 7091, CHATSWORTH, GEORGIA, and all appurtenences thereon, being approximately five acres of land, Lot 209 in the 26th District and 2nd Section of Murray County.

Dated at Rome, Georgia, this 20th day of September, 1996.

Luther D. Thomas, Clerk

By: s/ [illegible]
Deputy Clerk

APPENDIX D — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF GEORGIA, ROME DIVISION DATED JUNE 5, 1996 AND FILED JUNE 6, 1996

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ROME DIVISION

CIVIL ACTION
4:93-cv-335-HLM

UNITED STATES OF AMERICA,

Plaintiff,

v.

ROUTE 7, BOX 7091, CHATSWORTH, GEO GIA,

Defendant,

v.

KENNETH G. WITHROW,

Claimant,

FRANKLIN WITHROW,

Claimant.

Appendix D

ORDER

This is a civil forfeiture action filed against the defendant real property being approximately 5 acres consisting of all that tract or parcel of land, together with all buildings and appurtenances, lying and being in Land Lot 209 in the 26th District and 2nd Section of Murray County, Georgia with mailing address Route 7, Box 7091, Chatsworth, Georgia. Plaintiff contends that the defendant real property was used by Franklin Withrow to facilitate his manufacture of marijuana and that the defendant property is subject to forfeiture under the provisions of 21 U.S.C. § 881(a)(7). Plaintiff further contends that Franklin K. Withrow is the true owner of the defendant property and that claimant Kenneth Withrow is merely a nominal owner.

Kenneth Withrow contends he is the owner of the property and is an innocent owner.

Franklin Withrow contends his father, Kenneth Withrow, is the owner of the property and that he, Franklin Withrow, has the rights of a tenant at will in the property.

The case was tried to the Court without a jury. After considering the evidence and submissions of the parties the Court makes the following findings of fact and conclusions of law.

FINDINGS OF FACT

1. This action seeks a civil forfeiture against the real property titled in the name of Kenneth Withrow located at

Appendix D

Route 7, Box 7091, Chatsworth, Georgia, and all buildings and appurtenances thereon, being approximately five acres of Land Lot 209 in the 26th district and 2nd section of Murray County. The defendant property sits atop Fort Mountain in Murray County and has a house and garage located on it.

2. Since the early 1980's, United States Forest Service Special Agent Jim Crowe and other Forest Service agents have received information from other law enforcement agents and civilians that Franklin Withrow was growing and selling marijuana in the Murray County area.

3. Since approximately 1983, Special Agent Jim Crowe and other Forest Service agents have discovered numerous patches of marijuana growing near the residence of Franklin Withrow.

4. In the early summer of 1993, Forest Service agents, while flying in a helicopter, observed several small patches of marijuana near the residence of Claimant Franklin Withrow.

5. Subsequently, Forest Service Special Agent Jim Crowe and other Forest Service agents set up a surveillance camera in the patches. On one occasion, when Agent Crowe and another Forest Service agent approached the marijuana patches to service the surveillance camera, they observed a motorcycle that belonged to Franklin Withrow sitting in a trail that led to the marijuana patches. The agents observed Franklin Withrow return to his motorcycle from the area where the marijuana patches were located carrying a

short-handled hoe. The agents then followed the trail of footprints and impressions left by Franklin Withrow through the woods to a freshly watered marijuana patch.

6. On August 30, 1993, Forest Service agents placed a surveillance camera near another marijuana patch located near Franklin Withrow's residence. This marijuana patch was west of the defendant real property.

7. On September 7, 1993, agents checked the surveillance film, which showed Franklin Withrow on or about September 2, 1993, fertilizing and harvesting the marijuana plants in the patch near his residence. Franklin Withrow was carrying granular fertilizer in a plastic milk jug. He was wearing a blue short-sleeved shirt with a Polo logo on the front and pink shorts.

8. On September 8, 1993, agents of the Georgia Bureau of Investigation obtained a state search warrant for Franklin Withrow's residence on the defendant real property and an arrest warrant for Franklin Withrow.

9. On September 8, 1993, GBI agents arrested Franklin Withrow for manufacturing marijuana and law enforcement agents executed the search warrant at Franklin Withrow's residence.

10. While searching the residence on the defendant real property, agents seized marijuana plants hanging from a mounted deer head in the living room, several layers of drying marijuana with each layer separated by sheets of newspaper on a chair in the dining room, plastic bags of

marijuana in various rooms in the residence, two marijuana plants growing in the yard of Franklin Withrow's residence, a large twenty-five pound box of Miracle Grow fertilizer, a plastic milk jug containing granular fertilizer, a blue short-sleeved shirt with a Polo logo and pink Pacific Coast Highway shorts. The agents also located the motorcycle that Franklin Withrow had previously used to travel to the marijuana patches east of the defendant property and the short-handled hoe that he had used to cultivate those marijuana plants.

11. Franklin Withrow used the defendant real property to facilitate his manufacture of marijuana.

12. On November 17, 1993, the United States filed a verified complaint for forfeiture of the defendant real property pursuant to 21 U.S.C. § 881(a)(7) as a result of Franklin Withrow's use of the property to facilitate his manufacture and distribution or both of marijuana.

13. Claimant Kenneth Withrow, father of Franklin Withrow, filed a verified claim to the defendant real property and answer to the complaint claiming that he owns the defendant real property.

14. Franklin Withrow also filed a verified claim to the defendant real property and answer to the complaint. Franklin Withrow claims that he is not the true owner of the defendant real property, but claims only to have a usufruct interest in the property, i.e., he claims to be a tenant at will.

15. Although Kenneth Withrow is the record titleholder of the defendant real property, he has never exercised any dominion or control over the property since shortly after it was purchased.

16. Sharon Ruth Florence, f/k/a Sharon Moore Withrow was married to Franklin Withrow from March 1981 until October 1990.

17. Sharon Moore testified that, after discussions with Clyde and Lucretia Crouse — who lived near the defendant property and wanted neighbors in that remote area — she initiated the negotiations with Lucretia Crouse's uncles, Red and Sparky Ernest, which led to the purchase of the defendant property.

18. In 1981 the defendant real property was purchased for $15,000 and a house was built on the property.

19. Sharon Moore was married to Franklin Withrow when she and Franklin Withrow moved into the residence on the defendant real property in 1981. She and Franklin Withrow lived at the residence until their separation in 1989.

20. Sharon Moore testified that she and Franklin Withrow paid $2000 toward the purchase of the defendant real property and borrowed the remaining $12,000 of the purchase money from Kenneth Withrow.

21. Kenneth Withrow paid the purchase money for the defendant property, after cashing in a certificate of deposit, by check to Red and Sparky Ernest in the amount of $15,000.

22. Sharon Moore testified that she understood the monetary contribution of Kenneth Withrow toward the purchase of the property to be a loan that would be repaid by Sharon and Franklin Withrow plus the interest that Kenneth Withrow lost by cashing in the certificate of deposit.

23. Sharon Moore testified that she attempted to repay Kenneth Withrow the money used to purchase the defendant real property, plus the interest that Kenneth Withrow had lost by cashing in the certificate of deposit, either in monthly installments of $400 per month for three years or in a lump sum cash payment. She said Kenneth Withrow refused repayment, stating that he did not want to attract the attention of the IRS with any incoming cash payments.

24. Sharon Moore testified that she and Franklin Withrow always held themselves out to the world to be the owners of the defendant real property.

25. Kenneth Withrow resides in Gilmer County, Georgia, about fifteen miles from the defendant real property.

26. Kenneth Withrow has never lived on the defendant real property.

27. Kenneth Withrow visited the property only several times a year with weeks or months passing between visits. When he visited, he usually sat around and talked with Franklin Withrow and sometimes walked around in the woods to look at the spring or the ginseng Franklin Withrow was growing.

Appendix D

28. Sharon Moore testified that Kenneth Withrow only visited the defendant property about five times per year and that he never inspected the defendant property or asked any questions about the maintenance or repair of the house.

29. Franklin Withrow has lived on the defendant real property rent free since the house was built on the property in approximately 1981.

30. On or about November 17, 1993, Franklin Withrow was indicted by a grand jury in the Superior Court of Murray County, Georgia for unlawfully manufacturing marijuana and unlawfully possessing marijuana.

31. Franklin Withrow was incarcerated for a nine month period of time after pleading guilty to possession of marijuana.

32. Upon his release from prison on the marijuana conviction, Franklin Withrow immediately moved back into the house on the defendant property.

33. Franklin Withrow has resided on the defendant real property at all times except for his period of incarceration following his November 1993 conviction for possessing marijuana.

34. While Franklin Withrow was incarcerated for the marijuana possession conviction, Franklin Withrow's girlfriend, whom Kenneth Withrow knew as "Doris," lived rent free on the defendant real property.

35. Kenneth Withrow has little knowledge of who is residing on the defendant property with Franklin Withrow at any given time.

36. Kenneth Withrow testified at trial that he believed that "Doris" still lived on the defendant property part of the time, however, Franklin Withrow testified that she does not.

37. Kenneth Withrow testified that there has never been any rental agreement or lease between him and Franklin Withrow nor has Franklin Withrow ever paid any rent for his use and enjoyment of the defendant real property.

38. Franklin Withrow pays all of the utilities for the house and defendant real property and has done so since the house was built.

39. Sharon Moore testified that she and Franklin Withrow paid property taxes for the defendant real property and that Franklin Withrow never paid those expenses or reimbursed them for the payments.

40. Murray County property tax records show that, although Murray county billed taxes, tax adjustments, and penalties on the defendant real property to Kenneth Withrow as record titleholder of the defendant real property, Franklin Withrow paid the taxes, tax adjustments, and penalties.

41. Kenneth Withrow testified that Franklin Withrow and Sharon paid the property taxes and that he believed the source of the money to be from their own monies or from

rent received from the Anheuser-Busch Corporation for use of a tower on the property during a two to three year period.

42. Franklin Withrow's testimony conflicted with his father's testimony regarding payment of the property taxes because Franklin Withrow testified at trial that his father gave him cash with which to pay the taxes.

43. Sharon Moore testified that she and Franklin Withrow paid the homeowner's insurance premiums for the defendant real property by check and that Kenneth Withrow never paid these expenses or reimbursed them for the payments.

44. At trial, Kenneth Withrow testified that he never directly paid the insurance premiums nor reimbursed Franklin Withrow and that instead, Franklin Withrow and Sharon paid the premiums.

45. Franklin Withrow and Sharon had a homeowner's insurance policy in their names with State Farm & Casualty Company as owners of the property, which provided homeowner's insurance coverage for the defendant real property.

46. State Farm Insurance Agent Randy Dean testified that State Farm's policy is to only provide straight homeowner's insurance coverage, type HO-3, the type obtained by Franklin Withrow and Sharon, to individuals who own the insured property. He testified that State Farm provides a different "renters" type of insurance coverage, Type HO-4, to individuals who occupy but do not own the insured property.

47. Agent Dean testified that he had no contact with Kenneth Withrow regarding the defendant property and that Franklin Withrow never indicated to him that anyone other than Franklin Withrow and Sharon owned the defendant property.

48. On December 5, 1981, Franklin Withrow filed an insurance claim on his homeowner's insurance policy with State Farm Fire for damage to the residence on the defendant real property caused when a frozen water pipe burst.

49. On November 12, 1986, Franklin Withrow filed an insurance claim on his homeowner's insurance policy with State Farm for loss of firearms and jewelry when the residence on the defendant real property was burglarized.

50. A brick mason and a carpet layer each testified that they performed work at the defendant real property and that they did so to Franklin Withrow's specifications and that Kenneth Withrow was not involved in hiring them to perform the work.

51. Carlton Dwight Scott, a brick mason, testified that Franklin Withrow contracted him to lay the foundation for Franklin Withrow's house on the defendant real property, a garage, and additions to the house and sidewalk.

52. Kenneth Withrow testified at trial that he paid Mr. Scott for laying the blocks for the foundation.

53. Mr. Scott testified that all work that he performed on the defendant real property was done to Franklin

Withrow's specifications, that he never dealt with Kenneth Withrow regarding work on the defendant real property, and that he was paid for his work on the property by Franklin Withrow.

54. Amos Green, a carpet layer, testified that, shortly after the house on the defendant real property was built, at Franklin Withrow's request, he laid and repaired some carpet in Franklin Withrow's house on the defendant property. Green further testified that Franklin Withrow hired him and that he did the work for Franklin Withrow and never dealt with Kenneth Withrow regarding the work.

55. Sharon Moore testified that when the Budweiser plant was being built in Cartersville, the Anheuser-Busch Corporation leased a tower located on the defendant real property for communication purposes and paid her and Franklin Withrow rent biannually. Kenneth Withrow also testified that Franklin Withrow received the rental payments for the use of the tower.

56. Franklin Withrow signed an agreement for service with the Fort Mountain Estates Volunteer Fire Department that stated that Franklin Withrow was the owner of the defendant real property.

57. The claimants offered into evidence checks and invoices indicating Kenneth Withrow's purchase of construction materials such as nails, pipe, gravel, and concrete. Kenneth Withrow testified that, as to many of the checks, he was not sure what they were for and could only be sure that they were for construction materials if the

checks so indicated or if they were written to a building supply company. Kenneth Withrow testified that these supplies were for the construction of the house on the defendant property, however, nothing on the checks or invoices specifically indicates their relationship to the defendant property.

58. Kenneth Withrow testified that, after the house was constructed, a garage was built at Franklin Withrow's request, a large addition was built at Franklin Withrow's and Sharon's request, and exposed rafters were added at his son's request.

59. Sharon Moore testified that she and Franklin Withrow purchased $9600 worth of building materials for the construction of the defendant property, including water pumps and pressure treated lumber.

60. Kenneth Withrow testified that Franklin Withrow and Sharon purchased pressure treated lumber, which was used for a walkway and deck.

61. Sharon Moore testified that, during 1989, she discovered marijuana in a cooler in the garage on the defendant property and a garbage bag full of marijuana on top of plywood lying on the ceiling rafters in the unfinished addition to the house. She testified that she hid the garbage bag of marijuana and was soon confronted by Franklin Withrow who demanded to know what she had done with it. She testified that she retrieved the bag and threw it on the flood, scattering the marijuana, and then left the property for the last time.

Appendix D

62. Franklin Withrow testified that he was married once before his marriage to Sharon Moore. He testified that the house that he owned during his first marriage was "taken in the divorce" from his first wife.

63. Franklin Withrow testified that the house that was later taken from him in his first divorce was originally built by Kenneth Withrow for Franklin Withrow's grandparents. He testified that he and Kenneth Withrow remodeled the house when Franklin Withrow moved back from college and that Kenneth Withrow gave the house to Franklin Withrow.

64. Sharon Moore testified that, on one occasion during their marriage, Franklin Withrow told her that he had lost a house during his first divorce and that it was not going to happen again. She also testified that, after she had initiated divorce proceedings, Franklin Withrow told her that he would burn the house on the defendant property before he would let her have it.

65. Sharon Moore testified that she did not pursue an ownership interest in the defendant property during her divorce from Franklin Withrow, but instead sought and received a monetary payment from Franklin Withrow in satisfaction of property division.

66. At trial the Court asked Kenneth Withrow, "Why did you let your son live in the house all of these years rent free, if it was your house?" He answered "Judge that's a good question."

67. Kenneth Withrow further testified that he had let his other son, Johnny, live at home with Kenneth Withrow and his wife all of Johnny's life and that he felt like he owed it to Franklin Withrow to also give him a place to live.

68. Kenneth Withrow testified that he had cut "every stick" of wood in the house on the property except for the window molding which he could not cut. He testified that the wood came from trees grown on his farm that had been in his family since his grandfather. That he had purchased the land by assigning a $15,000 certificate of deposit. He introduced into evidence a carbon copy of the original assignment of the $15,000 CD, the original bank statement showing the deposit just prior to the closing and the withdrawal of $15,000 on the day of the closing, and the original check for $15,000 to the Sellers.

69. Kenneth Withrow denied that Franklin Withrow and Sharon had contributed any of the purchase price. He testified that he had personally constructed several other houses on other properties he had bought and that when he bought this property and built the house with the contributed labor of his sons he did not consider it as a permanent home for Franklin Withrow. He testified that he had provided a place of residence for both Franklin Withrow and his other son Johnny (both in their mid-40s) for nearly all of their lives although Johnny's residence has been in Kenneth Withrow's home.

70. Kenneth Withrow stated that he sawed the rough cut white pine siding, the roof rafters, and the rest of the

lumber for the house. He produced and introduced into evidence 29 checks for $4,727.63 for material he said was bought for the house. He introduced into evidence an additional 13 original invoices totaling $1,372.90 for material he said was used in the house construction. He testified that he physically built the subject house and that he had exercised dominion and control by deciding, for example, to require Franklin Withrow to remove a deck that Franklin Withrow had built that he felt was harmful to the property. He testified that he "allowed" Franklin Withrow to stay on the property.

71. Title to the subject property was taken in the name of Kenneth Withrow, the father of Franklin Withrow. Possession of the property came into the exclusive possession of Franklin Withrow in 1981 and remained in his exclusive possession until seized by the Government under this forfeiture action in 1993.

72. Franklin Withrow has never paid his father any rent for the premises. There was never any claim of dominion by Kenneth Withrow over the property until a claim was filed by him in this action. No disclaimer of title was made by Franklin Withrow until the instant action was filed. Neither Franklin Withrow or Kenneth Withrow has ever claimed a loan from Kenneth Withrow for purchase money for the property.

73. Although Kenneth Withrow provided funds for the purchase of the defendant property and provided some labor and materials for the construction of the house, he had no further involvement with the management or upkeep of the

defendant property. Just as he had previously provided Franklin Withrow with a house which Franklin Withrow subsequently lost in a divorce, and had provided his other son Johnny with a place to live, Kenneth Withrow gave the defendant property to Franklin Withrow. Kenneth Withrow has never exercised any dominion or control over the defendant property and is merely a record title owner. Franklin Withrow, who has always exercised ownership rights to the defendant property and held himself out to the world to be the owner of the defendant property, is the true owner of the defendant property.

CONCLUSIONS OF LAW

1.

A forfeiture proceeding is an *in rem* action brought against seized property pursuant to the fiction that the property itself is guilty of facilitating a crime. *See, Calero-Toledo v. Pearson Yacht Leasing Co.*, 416 U.S. 663, 680-84 (1974). To contest a forfeiture action, an individual must first demonstrate an interest in the seized property sufficient to satisfy the court of his standing as a claimant. *U.S. v. $346,960 in U.S. Currency*, 661 F.2d 319, 326 (5th Cir. 1981).

2.

If the claimant lacks standing, there can be no challenge to the forfeiture action. It is well established that in order to contest a forfeiture, a claimant must first demonstrate a sufficient interest in the property to give him/her Article

III standing; otherwise, there is no "case or controversy" in the constitutional sense, capable of adjudication in the federal courts. *U.S. v. $38,000*, 816 F.2d 1538, 1543 (11th Cir. 1987); *See also U.S. v. One 18th Century Colombian Monstrance*, 797 F.2d 1370 (5th Cir. 1986) *reh'g denied with opinion*, 802 F.2d 837, 838, *cert. denied, Newton v. United States*, 481 U.S. 1014 (1988); *U.S. v. $500,000*, 730 F.2d 1437, 1439 (11th Cir. 1984). Secondly, the claimant must establish statutory standing. *$38,000*, 816 F.2d 1538 (11th Cir. 1987).

3.

The burden to establish standing is on the claimant. *Rakes v. Illinois*, 439 U.S. 128, 130-131 (1978); *See U.S. v. $500,000*, 730 F.2d 1437 (11th Cir. 1984); *U.S. v. $280,505*, 655 F.Supp. 1487, 1495 (S.D. Fla. 1986). Accordingly, unless a claimant can demonstrate that he/she has a "legally cognizable interest in the property that will be injured if the property is forfeited" to the United States, this Court lacks jurisdiction to consider his/her claim. *$38,000 supra*, 816 F.2d at 1543-44 n. 12.

4.

It is the owner or owners of property who have standing to challenge a forfeiture. In general terms, ownership may be defined as a possessory interest in the seized property with its attendant characteristics of dominion and control. *U.S. v. 1945 Douglas C-54 (DC-4) Aircraft*, 604 F.2d 27, 28 (8th Cir. 1979); *U.S. v. Twenty Cashier's Checks*, 897 F.2d 1567, 1571 (11th Cir. 1990). However, "the possession

of bare legal title to the res may be insufficient to establish ownership" where, for instance, the title holder is only a nominal owner. *Id.* at 28-29; *See also U.S. v. 1945 Douglas C-54 (DC-4) Aircraft*, 647 F.2d 864, 866-867 (8th Cir 1981); *U.S. v. $280,505*, 655 F.Supp. 1487, 1495 (S.D. Fla. 1986). It is well established that documents of title are not the *sine qua non* of ownership. *U.S. v. DKG Appaloosa*, 630 F.Supp. 1540, 1548 E.D.Tx. 1986). Thus, bare legal title alone is not sufficient to establish standing in a forfeiture proceeding. *United States v. 526 Liscum Drive, Dayton, Montgomery County, Ohio*, 866 F.2d 213, 217 (6th Cir. 1988); *United States v. A Single Family Residence*, 803 F.2d 625, 630 (11th Cir. 1986); *United States v. One 1978 Piper Navajo PA-31 Aircraft*, 748 F.2d 316, 319 (5th Cir. 1984); *United States v. One 1945 Douglas C-54 (DC-4) Aircraft*, 604 F.2d 27, 28 (8th Cir. 1979) *cert. denied, Stumpff v. United States*, 454 U.S. 1143 (1982). The rationale behind this rule is based upon "a candid determination that things are often not what they appear to be, especially in the world of drug trafficking. . . . In brief, people engaged in illegal activities often attempt to disguise their interests in property by placing title in someone else's name." *A Single Family Residence*, 803 F.2d at 630, *quoting United States v. One 1977 36 Foot Cigarette Ocean Racer*, 624 F.Supp. 290, 294-95 (S.D. Fla. 1985).

5.

The claimant in a forfeiture action has the burden of clearly asserting and proving that he possesses a "legally cognizable interest in the property that will be injured if the property is forfeited" to the United States. *$38,000*, 816

F.2d at 1543-44, n.12. Thus, unless claimant, Kenneth Withrow, who claims to be the owner of the defendant property, can demonstrate that he has an interest in the property that will be injured if the property is forfeited to the United States, he lacks standing and this Court lacks jurisdiction to consider his claim. *$38,000.00*, 816 F.2d at 1543-44 n. 12; *See United States v. One 1971 Porsche Coupe*, 364, F.Supp. 745, 748 (E.D. Pa. 1973) (finding that claimant father lacked sufficient interest in property to challenge its forfeiture where he would not actually suffer from the loss of the property).

6.

A mere nominal owner, who fails to exercise dominion and control over the property, lacks standing to contest the forfeiture of the seized property. *See, e.g., United States of America v. Approximately 11.947 Acres . . . on Boss Hardy Road, Barrow County, Georgia*, Civil Action No. 2:90-CV-0005WCO slip op. (N.D. Ga. December 9, 1991).

7.

The facts here are that Kenneth Withrow has never lived on the defendant property and visited the property only several times a year to speak with his son. Kenneth Withrow's son Franklin Withrow has lived on the defendant property rent free since the house was built on the property. Franklin Withrow returned to live on the property following his incarceration for possessing marijuana on the defendant property. During Franklin Withrow's incarceration for possessing marijuana on the defendant property, Kenneth

Appendix D

Withrow was aware that Franklin Withrow's girlfriend — a woman known to Kenneth Withrow as "Doris" — was living on the defendant property rent free. Kenneth Withrow has little knowledge of who resides on the defendant property with Franklin Withrow at any given time. Franklin Withrow grew marijuana on the defendant property and openly stored and dried marijuana throughout the house on the defendant property — even hanging it from a mounted deer head in the living room — without any apparent fear of being discovered. Franklin Withrow also previously stored marijuana on the defendant property in the garage and in garbage bags in an unfinished addition to the house. Franklin Withrow and his former wife, Sharon, paid the property taxes, insurance premiums, and utilities for the defendant property and also paid for construction materials and labor on the residence. A garage, exposed ceiling rafters, and, a large addition to the house on the defendant property were built at Franklin Withrow's and his wife's request. Franklin Withrow previously lost a house given to him and built by his father Kenneth Withrow in a divorce, and thus, Kenneth Withrow had every incentive to keep the defendant property titled in his name to protect it. Franklin Withrow has held himself out to the world to be the owner of the defendant property.

8.

Claimant Kenneth Withrow never exercised any dominion or control over the defendant property. He has failed to prove that he was ever more than a mere nominal owner.

Appendix D

9.

Georgia Law at O.C.G.A. § 44-5-85 provides:

> The exclusive possession by a child of lands which originally belonged to the parent or parents, without payment of rent, for the space of seven years, creates a conclusive presumption of a gift and conveys title to the child, unless there is evidence of a loan, of a claim of dominion by the parent or parents acknowledged by the child, or of a disclaimer of title by the child.

10.

In the instant case the son, Franklin Withrow, was in exclusive possession of land which belonged to his father, without payment of rent. There was no loan between Kenneth and Franklin Withrow for the property. No claim of dominion was made by Kenneth Withrow or disclaimer made by Franklin Withrow until some twelve years after Franklin Withrow went into exclusive possession of the property. A conclusive presumption arose after seven years from Franklin Withrow taking exclusive possession of the property that it was a gift to him from his father. At the conclusion of seven years Franklin Withrow became the owner of the subject property. *Sims, et al. v. Holtzclaw, et al.*, 259 Ga. 537, (1989).

Appendix D

11.

Kenneth Withrow lacks standing as he has failed to show that he will be injured by the forfeiture of the defendant property. It is clear that Franklin Withrow is the true owner of the property and is the only one who will be injured by the forfeiture of the property.

12.

Kenneth Withrow has failed to prove he has any ownership interest in the property.

13.

Claimant Franklin Withrow has claimed only a "usufruct" interest in the defendant real property, akin to asserting that he has a "tenancy at will," and has claimed that his father is the owner of the property. The interest in real property of a tenant at will or holder of a "usufruct" is no greater than the interest of the landlord or owner.

14.

To the extent that Franklin Withrow has only claimed a usufruct or "tenancy at will" interest in the defendant property, he cannot recover against the United States because claimant Kenneth Withrow, whom Franklin Withrow claims to be the landlord and owner of the defendant property, has intervened and asserted his alleged superior rights to the defendant real property.

Appendix D

15.

Claimant Franklin Withrow's claimed interest as the holder of a usufruct as to the defendant property is a lesser included interest of Kenneth Withrow's claimed ownership interest. Thus, to the extent that Franklin Withrow's claim is limited to a usufruct interest or tenant at will, because claimant Kenneth Withrow has failed to establish standing to contest this forfeiture action, Franklin Withrow's claim also fails. However, inasmuch as Franklin Withrow is in fact the true owner of the defendant property, he does have standing in that capacity.

16.

To achieve forfeiture under 21 U.S.C. § 881(a)(7), the United States must establish probable cause to believe that the defendant real property was used, or was intended to be used, in any manner or part, to commit or to facilitate illegal drug activity. 21 U.S.C. § 881(a)(7). The burden is on the United States to establish probable cause for the belief that a substantial connection exists between the property to be forfeited and an illegal drug transaction. *United States v. $4,255,625.39*, 762 F.2d 895, 903 (11th Cir. 1985). *cert. denied*, 474 U.S. 1056 (1986).

17.

In demonstrating a substantial connection between the defendant property and illegal drug transactions, the government is not required to show that the property was integral, essential, or indispensable to the drug activity; *See*

e.g. United States v. Approximately 50 Acres of Real Property, 920 F.2d 900, 902 (11th Cir. 1991) (*per curiam*); *United States v. Real Property and Residence at 3097 S.W. 11th Avenue*, 921 F.2d 1551 (11th Cir. 1991); *United States v. Reynolds*, 856 F.2d 675 (4th Cir. 1988); *United States v. Premises Known as 3639 2nd Street, N.E.*, 869 F.2d 1093 (8th Cir. 1989); *United States v. Santoro*, 866 F. 2d 1538, 1545 (4th Cir. 1989); *United States v. 1964 Beechcraft Baron Aircraft*, 691 F.2d 725, 727-28, *cert. denied*, 461 U.S. 94 (1983) (5th Cir. 1982); *United States v. 26.075 Acres in Swift Creek Township*, 687 F.Supp. 1005 (E.D.N.C. 1988); *United States v. 124 East North Avenue*, 651 F.Supp. 1350, 1353-4 (N.D.Ill, 1987); *Calero-Toledo v. Pearson Yacht Leasing Co.*, 416 U.S. 663 (1974).

18.

Courts agree that property may "facilitate' illegal drug activity if it makes the illegal activity "easy or less difficult,' *United States v. One 1980 Bertram 58' Motor Yacht*, 876 F.2d 884, 887 n.3 (11th Cir. 1989), or if it lessens the labor involved in handling the illegal substances. *United States v. One 1971 Chevrolet Corvette Auto*, 496 F.2d 210, 212 (5th Cir. 1974).

19.

This Court has recognized that, "[u]nder 21 U.S.C., § 881(a)(7) property is subject to forfeiture if it is merely intended to be used to facilitate the commission of a drug violation." *See United States v. All That Tract . . . 2262 Cave Springs Road, et al.*, Civil Action No. 4:90-cv-

170-HLM (March 19, 1991, Murphy, J.), slip op. at 3; *See also United States v. Approximately 50 Acres of Real Property*, 920 F.2d 900, 902 (11th Cir. 1991) (*per curiam*) (finding that evidence that property was used to negotiate and plan essential component of drug transaction was sufficient connection). *United States v. Real Property and Residence at 3097 S.W. 111th Avenue*, 921 F.2d 1551 (11th Cir. 1991) (finding property subject to forfeiture based on planned delivery of cocaine in driveway of residence); *United States v. 124 East North Avenue*, 651 F.Supp. 1350, 1353-4 (N.D.Ill, 1987) (finding that regular use of telephone to coordinate sale and delivery of cocaine plus intent to use home as situs of delivery of 5 kilos of cocaine constituted probable cause to forfeit under § 881(a)(7)).

20.

Furthermore, growing marijuana, whether or not for personal use, is an activity sufficient to subject the property on which cultivation occurs to civil forfeiture under section 881(a)(7). *See United States v. One Parcel of Real Property*, 960 F.2d 200 (1st Cir. 1992).

21.

The definition of probable cause is a reasonable ground for belief of guilt supported by less than prima facie proof but more than mere suspicion. Probable cause is judged not with clinical detachment but with a common sense view to the realities of normal life. *United States v. A Single Family Residence*, 803 F.2d 625, 628 (11th Cir. 1986); *United States v. One 1979 Porsche Coupe*, 709 F.2d 1424, 1426 (11th Cir. 1983).

Appendix D

22.

The existence of probable cause is a matter of law. *United States v. Nixon*, 629 F.Supp. 857, 858 (N.D. Ala. 1986) (citing *United States v. Four Million Two Hundred and Fifty-Five Thousand*, 762 F.2d 895, 903 n. 17 (11th Cir. 1985); *cert. denied*, 106 S.Ct. 795 (1986)); *United States v. 1982 Yukon Delta Houseboat*, 774 F.2d 1432, 1434 (9th Cir. 1985). Probable cause may be based wholly on circumstantial evidence, which may include facts learned after the seizure. *United States v. $41,305.00 in Currency & Traveler's checks*, 802 F.2d 1339, 1343 (11th Cir. 1986); *Four Million Two Hundred and Fifty-Five Thousand*, 762 F.2d at 902 n. 12, 904.

23.

Moreover, hearsay may be used to establish probable cause. *United States v. A Single Family Residence*, 803 F.2d 625, 629 n.2 (11th Cir. 1986). *See also United States v. Miscellaneous Jewelry*, 667 F. Supp. 232, 238 (D. Md. 1987), *aff'd, One 1985 Nissan 300 ZX, et al.*, 889 F.2d 1317 (4th Cir. 1989) (citing *A Single Family Residence*) (stating that the United States may use hearsay to show probable cause); *United States v. Nixon*, 629 F.Supp. 857. 858 (N.D. Ala. 1989) (citing *Bush v. United States*, 389 F.2d 485 (5th Cir. 1968)).

24.

Probable cause exists to believe that the defendant real property was used, and was intended to be used, to facilitate

the manufacture, sale and/or distribution of marijuana in violation of 21 U.S.C. § 881(a)(7).

25.

Once the government makes a sufficient showing of probable cause, the burden of proof in a civil forfeiture proceeding shifts to the claimant to show, by a preponderance of the evidence, that the defendant real property is not subject to forfeiture. *United States v. $4,255,625.39*, 762 F.2d 895, 904 (11th Cir. 1985). A claimant can meet this burden by either rebutting the government's evidence that the defendant real property was used to facilitate illegal drug activities or by showing that he or she is an innocent owner who did not know of the property's connection with drug sales. *United States v. A Single Family Residence*, 803 F.2d 625, 629 (11th Cir. 1986). Failure to rebut a showing of probable cause to believe the defendant property was used or intended to be used to facilitate a violation of Title 21 U.S.C. is sufficient by itself to warrant forfeiture. *United States v. $5,644,540.00 in United States Currency*, 799 F.2d 1357, 1362 (9th Cir. 1986); *United States v. Little Al*, 712 F.2d 133, 136 (5th Cir. 1983). In the instant case, the claimants have failed to rebut the government's evidence that the defendant real property was used to facilitate the manufacture of marijuana.

26.

All persons and entities connected with real property subject to forfeiture are wrongdoers except those who are innocent owners. *United States v. One Single Family*

Appendix D

Residence Located at 15603 85th Avenue North, Lake Park, Palm Beach County, Florida, 933 F.2d 976, 981 (11th Cir. 1991).

27.

In the context of civil forfeiture actions, an individual asserting the defense of "innocent ownership" must establish (1) that he or she was uninvolved in the wrongful activity, (2) that he or she was unaware of the wrongful activity, and (3) that he or she "had done all that reasonably could be expected to prevent the proscribed use of the property." *Calero-Toledo v. Pearson Yacht Leasing Company*, 416 U.S. 663, 689-90, 94 S.Ct. 2080, 2094-95 (1974).

28.

The evidence in this case was unrebutted that there is probable cause to believe the defendant real property was used or intended to be used to facilitate the manufacture, sale and/or distribution of marijuana, and therefore, the property is forfeited to the United States pursuant to Title 21 U.S.C. § 881(a)(7).

29.

Furthermore, notwithstanding the fact that Franklin Withrow limited his claim to the defendant property to a usufruct or tenancy at will, interest which is now defeated in light of the failure of Kenneth Withrow to establish standing, Franklin Withrow is in fact the true owner of the defendant property and has standing in that capacity.

However, it is clear that Franklin Withrow used the defendant property to facilitate his manufacture of marijuana in violation of 21 U.S.C. § 881(a)(7), and he is not an innocent owner of the defendant property. Therefore, the defendant property shall be forfeited to the United States unless claimant can prevail upon his double jeopardy claim.

30.

The Court reserved the double jeopardy issue in this case until after a decision upon the factual issues.

31.

It is now appropriate for the Court to consider the double jeopardy claim made by claimants.

ACCORDINGLY, the parties shall have ten days within which to file briefs upon this remaining issue; and, the Clerk shall then submit this case to the Court for further consideration.

IT IS SO ORDERED, this the 5th day of June, 1996.

s/ Harold L. Murphy
UNITED STATES DISTRICT JUDGE

APPENDIX E — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT DATED AND FILED MARCH 10, 1999

IN THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

No. 96-9237

UNITED STATES OF AMERICA,

Plaintiff-Appellee,

versus

ROUTE 7, Box 7091, CHATSWORTH, GEORGIA, and all appurtenances thereon, being approximately five acres of land lot 209 in the 26th district and 2nd second of Murray County,

Defendant,

KENNETH G. WITHROW, clm,
FRANKLIN WITHROW, clm,

Claimants-Appellants.

On Appeal from the United States District Court for the Northern District of Georgia

BEFORE: TJOFLAT, BIRCH, and CARNES, Circuit Judges.

Appendix E

PER CURIAM:

The petition for rehearing filed by the Appellants, Kenneth G. Withrow and Franklin Withrow is GRANTED as to the question of whether the seizure of the property at issue violated the Fifth Amendment Due Process Clause, and, if so, whether as a result of the seizure the appellants were deprived of rents they would have received from their property. *See United States v. 408 Peyton Road*, 162 F.3d 644, 652 (11th Cir. 1998) (en banc). The case is REMANDED to the district court for reconsideration in light of *408 Peyton Road.* In all other respects, the petition is DENIED.

ENTERED FOR THE COURT:

s/ [illegible]
UNITED STATES CIRCUIT JUDGE

(2)

COPY
SUPREME COURT, U.S.
FILED
AUG 6 1999
OFFICE OF THE CLERK

No. 98-1967

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1998

F. W. WOOLWORTH CO. and
KINNEY SHOE CORPORATION, *Petitioners*,

v.

FRANCHISE TAX BOARD, *Respondent*.

ON PETITION FOR WRIT OF CERTIORARI TO THE
COURT OF APPEAL OF CALIFORNIA

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

BILL LOCKYER
Attorney General
TIMOTHY G. LADDISH
Senior Assistant Attorney General
RANDALL P. BORCHERDING
Supervising Deputy Attorney General
JOYCE E. HEE
Deputy Attorney General
Counsel of Record
1515 Clay Street, 20th Floor
Oakland, California 94612-1413
Telephone: (510) 622-2227
Fax No: (510) 622 2121
Counsel for Respondent

33pp

QUESTION PRESENTED

Petitioners challenge the constitutionality of what is referred to as the "interest offset" provision contained in section 24344(b) of the California Revenue and Taxation Code.[1/] The questions presented are as follows:

> (1) Does the limitation of Woolworth's business interest expense deduction by the amount of its nonbusiness dividend income derived from Woolworth's non-unitary foreign subsidiaries pursuant to Section 24344(b) mean that that dividend income is being indirectly taxed by California in violation of the Due Process Clause of the United States Constitution, or does this interest offset provision represent a reasonable means to apportion a multi-state business's interest expense between sources within California and without the state in accordance with established unitary business principles and to avoid a tax loophole?
>
> (2) Does application of the interest offset provision of Section 24344(b) violate the Commerce Clause of the United States Constitution?
>
> (3) Does application of the interest offset provision of section 24344(b) violate the Equal Protection Clause of the United States Constitution?

---

1. All future section references are to the California Revenue and Taxation Code unless otherwise indicated.

PARTIES IN THE COURT BELOW AND RULE 29.6 LIST

Respondent accepts the Petitioners' statements in this regard.

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

PARTIES IN THE COURT BELOW AND RULE 29.6 LIST ii

OPINIONS BELOW 1

STATEMENT OF THE CASE 1

A. The Interest Offset Provision - Section 24344(b) 3

B. Application Of The Interest Offset Provision To Woolworth 5

REASONS FOR DENYING THE WRIT 6

I. The Issues In This Case Do Not Warrant This Court's Review 6

II. The Court of Appeal Decision Upholding Section 24344(b) Is Correct 8

A. The Limitation On Woolworth's Interest Expense Deduction Pursuant To Section 24344(b) Does Not Result In Either Direct Or Indirect Taxation Of Constitutionally Immune Dividend Income In Violation Of The Due Process Clause Of The United States Constitution 8

TABLE OF CONTENTS, CONT'D

B. The Purpose And Logic Of Section 24344(b), As Analyzed In Pacific Telephone, Remain Viable 14

C. The Interest Offset Provision Does Not Contravene The Commerce Clause 18

D. The Interest Offset Provision Does Not Contravene The Equal Protection Clause 24

CONCLUSION 25

TABLE OF AUTHORITIES

Page

Cases

Allied Signal Inc. v. *Director, Div. of Taxation*
504 U.S. 768 (1982) 2

Allied Stores of Ohio, Inc. v. *Bowers*
358 U.S. 522 (1959) 24

Amerada Hess v. *Director, N.J. Dept. of Treasury*
490 U.S. 66 (1989) 23

ARMCO, Inc. v. *Hardesty*
467 U.S. 638 (1984) 22

Butler Brothers v. *McColgan*
17 Cal.2d 664, 111 P.2d 334 (1941) 1

Container Corp. v. *Franchise Tax Bd.*
463 U.S. 159 (1983) 2, 17, 23

Denman v. Slayton
282 U.S. 514 (1931) 12, 14

Edison California Stores v. *McColgan*
30 Cal.2d 472, 183 P.2d 16 (1947) 1

Exxon Corp. v. Wisconsin Dept. of Revenue
447 U.S. 207 (1980) 2

F. W. Woolworth Co. v. *Taxation and Revenue Department*
458 U.S. 354 (1982) 1

TABLE OF AUTHORITIES, CONT'D

First Nat. Bank v. Bartow Cty. Tax Assrs.
470 U.S. 583 (1985) 13

Fulton Corp. v. *Faulkner*
516 U.S. 325 (1996) 21

Helvering v. Independent Life Ins. Co.
292 U.S. 371 (1934) 13-14

Madden v. Kentucky
309 U.S. 83, 88 (1940) 24

Minnesota v. Clover Leaf Creamery Co.
449 U.S. 456 (1981) 24

Mobil Oil Corp. v. *Commissioner of Taxes*
445 U.S. 425 (1980) 2

Pacific Telephone & Telegraph Co. v.
Franchise Tax Board
7 Cal.3d 544, 498 P.2d 1030 (1972) . . . . . 4, *passim*

Safeway Stores, Inc. v. *Franchise Tax Bd.*
3 Cal.3d 745 (1970) 21

Tenneco West, Inc. v. *Franchise Tax Bd.*
234 Cal.App.3d 1510 (1991) 2

Trinova Corp. v. Michigan Treasury Dept.
498 U.S. 358 (1989) 23

Tyler Pipe Inds. v. *Dept. of Revenue*
483 U.S. 232 (1987) 22

TABLE OF AUTHORITIES, CONT'D

United States v. *Atlas Life Ins. Co.*
381 U.S. 233 (1965) 13

Western & Southern Life Ins. Co.
v. *State Board of Equalization*
451 U.S. 648 (1981) 24

Constitutional Provisions

U.S. Constitution
Commerce Clause . . . . . i, passim
Due Process Clause . . . . . i, 2, 8, 16
Equal Protection Clause . . . . . i, 24, 25

Statutes

Cal. Rev. & Tax. Code
§ 23151 1
§ 24344 . . . . . 3, *passim*
§ 24344(b) . . . . . 4, *passim*
§ 24402 21
§ 25101 . . . . . 1, 4
§§ 25120-25139 2
§ 25123 . . . . . 3, 5
§ 25126 . . . . . 3, 5
§ 25128 . . . . . 2, 3

Court Rules

California Rules of Court
Rule 977 6

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Respondent Franchise Tax Board of the State of California respectfully submits this brief in opposition to the petition for writ of certiorari.

OPINIONS BELOW

The relevant appellate opinion and related judgment and orders are contained in Petitioners' Appendix.

STATEMENT OF THE CASE

This is a tax refund case wherein Petitioners challenge the constitutionality of a tax statute referred to as the "interest offset" provision which applies to a corporation engaged in a unitary business. California imposes a franchise tax on every corporation doing business within the state. (Cal. Rev. & Tax. Code § 23151.) A corporation is taxed in this state only on the basis of its income from California sources. Thus, the measure of tax is a corporation's net income derived from or attributable to sources within the state. (Cal. Rev. & Tax. Code § 25101.)

Net income derived from or attributable to sources within California is determined on the basis of unitary business principles. (See *F. W. Woolworth Co.* v. *Taxation and Revenue Department*, 458 U.S. 354 (1982); *Butler Brothers* v. *McColgan*, 17 Cal.2d 664, 111 P.2d 334 (1941), aff'd. 315 U.S. 501 (1942); *Edison California Stores* v. *McColgan*, 30 Cal.2d 472, 183 P.2d 16 (1947).) Unitary business principles describe a method of taxation whereby a business conducted by related taxpayers as a single economic enterprise and which earns income both within and without

California is treated as one unit for determining income attributable to the State. (*Container Corp.* v. *Franchise Tax Bd.*, 463 U.S. 159 (1983); *Tenneco West, Inc.* v. *Franchise Tax Bd.*, 234 Cal.App.3d 1510, 1518-1519, 286 Cal.Rptr. 354, 356-357 (1991).) Where a corporation is engaged in a unitary, and not a separate, business with other corporations comprising the parent and its subsidiary corporations, income is apportioned to California by reference to the total combined business net income of the entire unitary group.

That portion of a taxpayer's business income which has a California source is determined by applying an apportionment formula as outlined in the Uniform Division of Income for Tax Purposes Act ("UDITPA") (Cal. Rev. & Tax. Code §§ 25120-25139). The combined income of the unitary members is apportioned by the application of three factors -- sales, payroll and property -- which are averaged to arrive at an apportionment factor, which is then applied to the business income of the unitary group. (Cal. Rev. & Tax. Code § 25128.)

The apportionable income of a taxpayer does not include any of the dividend income that is nonbusiness income that the taxpayer receives. (Cal. Rev. & Tax. Code §§ 25121-25128). "The Due Process and Commerce Clauses of the Constitution do not allow a State to tax income arising out of interstate activities -- even on a proportional basis -- unless there is a '"minimal connection" or "nexus" between the interstate activities and the taxing State, and "a rational relationship between the income attributed to the State the intrastate values of the enterprise."'" (*Container*, *supra*, 463 U.S. at pp. 165-166, quoting *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207, 219-220 (1980), quoting *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 437 (1980); *Allied Signal Inc.* v. *Director, Div. of Taxation*, 504 U.S. 768, 772, 777-78 (1982).) In this case the taxpayer received dividend income which is nonbusiness income.

A. The Interest Offset Provision - Section 24344(b).

The California Court of Appeal succinctly and accurately summarized the application of California's interest offset provision (Section 24344(b)), as follows.

> "In calculating the corporate franchise tax, California follows the Uniform Division of Income for Tax Purposes Act (UDITPA) (Cal. Rev. & Tax. Code] § 25120 et seq.), which makes a distinction between business and nonbusiness income. [fn. omitted.] Business income is generally calculated by applying an apportionment formula based on sales, property and payroll to the corporation's unitary business income. ([Cal. Rev. & Tax. Code] § 25128.) Nonbusiness dividend income is not apportioned, but it is taxable by the corporation's state of domicile. ([Cal. Rev. & Tax. Code] §§ 25123, 25126.)
>
> In calculating taxable net income under the apportionment approach, section 24344 provides for the deduction of interest expense, subject to certain limitations. Under subsection (b), interest expense is fully deductible to the extent of business interest income. Additional interest expense is then offset against nonbusiness interest and dividend income (which is not subject to allocation by formula), with the remaining interest deductible. Applying this section, the [Franchise Tax] Board disallowed [petitioner Woolworth's] interest expense deduction on a dollar-for-dollar basis to the extent it received dividends from its nonunitary subsidiaries." (Appendix A: Opinion of

California Court of Appeal ["Op."] at pp. 14-15.)[2/]

The "interest offset" set forth in section 24344(b) follows the basic tenet of tax law that a taxpayer may not receive a deduction for expenses which are attributable to income which is not subject to tax. As explained by the California Supreme Court in *Pacific Telephone & Telegraph Co. v. Franchise Tax Board*, 7 Cal.3d 544, 555, 498 P.2d 1030 (1972), because California only imposes a tax on income that is attributable to sources within this state, where a corporation is engaged in activities within and without California, expenses must also be assigned to sources within this state and to sources without this state. (Cal. Rev. & Tax. Code § 25101.) If this were not done, a taxpayer would receive a deduction for all of its expenses even though all of its income was not being taxed by California, and even though a portion of those expenses was attributable to the income not being taxed. Interest expense must be assigned to prevent corporations from creating "a deduction for the interest expense without the offsetting income". (*Pacific Telephone*, *supra*, 7 Cal.3d at p. 554, 498 P.2d at p. 1037.)

Section 24344(b) provides for a method of assigning interest expense between income which is "subject to apportionment by formula" (i.e. income which is considered in the base used to determine the income upon which California tax is assessed), and income not "subject to apportionment by formula". Under section 24344(b), interest expense is deductible to the extent of business interest income (i.e. interest income which is subject to apportionment by formula). Due to the inherent imprecision in assigning interest expenses between business and

---

2. "Op." means the opinion rendered by First Appellate District Court of Appeal, Division Three, in this case. (See Petitioners' Appendix A-1.)

nonbusiness sources, however, the remaining interest expense is then "offset" by the amount of interest and dividend income not subject to apportionment by formula. Any additional interest expense remaining after the application of the interest offset provision is deductible in determining net business income.

B. Application Of The Interest Offset Provision To Woolworth.

Petitioner F.W. Woolworth was incorporated in New York and maintained its principal place of business there. F.W. Woolworth Co. conducted business in numerous states, including California, and had many domestic and foreign subsidiaries.

In the lower courts, F.W. Woolworth Co. contended that it was engaged in a unitary business with its wholly owned subsidiary, Kinney Shoe Corporation. Respondent prevailed against Petitioners Woolworth and Kinney on this issue at trial, and the appellate court upheld the lower court's decision that Woolworth and Kinney did not constitute a unitary business during the years at issue. Petitioners did not raise the unitary issue in their petition for review in the California Supreme Court and therefore have conceded this issue.

The sole issue before this Court is the constitutionality of Section 24344(b). It is undisputed by the parties that Woolworth's foreign subsidiaries were not part of its unitary business. Therefore, the dividends Woolworth received from its nonunitary foreign subsidiaries constituted nonbusiness dividend income that is immune from taxation by California but which is subject to tax in New York, Woolworth's state of domicile. (Cal. Rev. & Tax. Code §§ 25123, 25126.)

Respondent Franchise Tax Board employed the constitutionally validated three-factor apportionment approach to calculate Woolworth's taxable net income. In doing so, Respondent applied the interest offset provision of Section 24344(b) as follows. For each year at issue, Woolworth's interest expense first was treated as fully deductible to the extent of its business interest income. To the extent that Woolworth had any additional interest expense, the deduction for such interest expense was then offset against, or reduced by, the nonbusiness dividend income it received from its non-unitary foreign subsidiaries. Any interest expense remaining after the application of the interest offset provision was treated as fully deductible.

REASONS FOR DENYING THE WRIT

I. The Issues In This Case Do Not Warrant This Court's Review.

This Court should deny the petition for writ of certiorari because the issues raised are not of sufficient importance to warrant this Court's review. The Court of Appeal declined to publish its opinion in this case, the California Supreme Court denied review, and the issues raised herein lack national import or significance.[3/] Thus, this case does not

---

3. California Rules of Court, Rule 977 provides:

"Rule 977. (a) An opinion of a Court of Appeal or an appellate department of the superior court that is not certified for publication or ordered published shall not be cited or relied on by a court or a party in any other action or proceeding except as provided in subdivision (b).

(b) Such an opinion may be cited or relied on:

(1) when the opinion is relevant under the doctrines of law of the case, res judicata, or collateral estoppel; or

warrant the extraordinary exercise of discretion by this Court and the petition should be denied.

In support of their constitutional challenges to California's interest offset provision, Petitioners ask this Court to place Section 24344(b) under a microscope where the narrow focus distorts its purpose and effect and obfuscates its true function within the overall context of California's apportionment scheme under UDITPA.

In short, it is well settled in tax law that a taxpayer is not entitled to a deduction for expenses that are attributable to income which is not subject to tax. California may only tax income that is attributable to sources within the state. Where a corporation conducts business both within and without California, both the corporation's income and expenses must be assigned to sources within the state and to sources without the state in order to properly calculate the corporation's taxable net income. Analyzed within the overall context of California's apportionment scheme, Section 24344(b) is simply one reasonable means to apportion a multi-state business's interest expense between sources within the state and without the state in accordance with accepted unitary business principles and to avoid a tax loophole.

As will be demonstrated *infra*, section 24344(b) is not a machiavellian vehicle for discriminating against nondomiciliary corporations in favor of corporations domiciled in California as Petitioners would have this Court believe. The objective and function of California's interest

---

(2) when the opinion is relevant to a criminal or disciplinary action or proceeding because it states reasons for a decision affecting the same defendant or respondent in another such action or proceeding."

offset provision are based upon apportionment principles previously affirmed by this Court. Applying those standards, the limitation of Woolworth's interest expense deduction by the amount of its nonunitary dividend income does not mean that California is taxing this income.

II. The Court of Appeal Decision Upholding Section 24344(b) Is Correct.

A. The Limitation On Woolworth's Interest Expense Deduction Pursuant To Section 24344(b) Does Not Result In Either Direct Or Indirect Taxation Of Constitutionally Immune Dividend Income In Violation Of The Due Process Clause Of The United States Constitution.

Petitioners contend that Section 24344(b)'s limitation of their tax deduction for interest expense in the dollar-for-dollar amount of the nonbusiness dividend income Woolworth received from its nonunitary foreign subsidiaries results in the taxation of that constitutionally immune income. According to Petitioners' analysis, consideration of this nonbusiness dividend income in calculating apportionable income, irrespective of the purpose of such consideration, would mean that California is taxing the income in violation of the Due Process Clause. This is not the case.

Section 24344 is premised on the idea that a state bears no obligation to allow a deduction for an expense relating to dividend income which that state is barred from taxing. The interest offset rule is an ordering rule for the deduction of interest expense and constitutes a legislative attempt to assign a proper income source to interest expense, such that only interest expense which is properly attributable to business

activities is available as a deduction against business income.

Given the fungible nature of money, however, it is virtually impossible to trace borrowed funds to determine whether interest expense was incurred for business or nonbusiness (investment) purposes. Money which a corporation ostensibly borrows to finance its business operations can easily be converted to finance, either directly or indirectly, nonbusiness investment activities. Moreover, even when borrowed funds are in fact used for business purposes, the mere act of borrowing will generally make available other funds which the corporation can utilize for nonbusiness purposes. Thus, the interest offset rule, as explained by the California Supreme Court in *Pacific Telephone*, *supra* (see discussion below), constitutes a rational legislative assignment of interest expenses to business or nonbusiness sources, thereby preventing a corporation from obtaining a tax deduction for an interest expense attributable to income immune from California taxation.

In holding that the application of Section 24344(b) does not result in the indirect taxation of constitutionally immune income, the Court of Appeal relied upon the California Supreme Court's analysis in *Pacific Telephone*, *supra, 7 Cal.3d 544; 498 P.2d 1030.* Respondent believes that that analysis is accurate and in keeping with fundamental apportionment principles that have been repeatedly affirmed by this Court.

In *Pacific Telephone*, the taxpayer contended that the limitation on deductible interest expense imposed by section 24344 should only apply to taxable dividend income and not to nontaxable dividend income allocated outside of California. The California Supreme Court rejected such a reading of section 24344 on the following grounds.

First, the statute does not refer to "taxable income," but rather to "interest and dividend income . . . not subject to allocation by formula." (*Pacific Telephone*, *supra*, 7 Cal.3d at p. 553, 498 P.2d at p. 1037.) Second, nontaxable dividends (dividends not allocated to California) fall within the logic of the interest offset provision, which is to offset interest expense to the extent possible against investment income. (*Pacific Telephone*, *supra*, 7 Cal.2d at p. 554, 498 P.2d at p. 1037.)

The California Supreme Court stated at 7 Cal.2d at pages 551-552, 498 P.2d at p. 1036:

> "In treating interest expense as the opposite of investment income (interest and dividend income), the subsection is obviously approaching the problem presented in a reasonable manner. Interest expense is the opposite of interest income, and dividend income is sufficiently analogous to interest income that it is reasonable to provide for the offset of interest expense against dividend income."

Nontaxable dividends thus qualify as investment income within the meaning of Section 24344.

Third, a reading of the interest offset provision which takes into account only taxable income, but not nontaxable dividends, would create a "loophole" for taxpayers. The California Supreme Court explained:

> "A foreign corporation could avoid all taxes in California merely by increasing its borrowing to create an interest deduction and then purchasing stocks which pay dividends. Since under the principle of *mobilia sequuntur personam*, the dividends will not be taxed, the corporation would

> have created a deduction for the interest expense without the offsetting income. **To avoid the loophole, the deduction must be reduced by the income even though the income cannot be taxed in California.**" [Fn. omitted; emphasis added.] (*Pacific Telephone*, *supra*, 7 Cal.2d at p. 554, 498 P.2d at p. 1037.)[4/]

Fourth, the phraseology of section 24344 suggests that the statute was intended to "act as a limitation on the amount of interest expense." (*Ibid.*) The California Supreme Court then proceeded to specifically hold that dividends are to be included in the calculation of interest offset under section 24344 regardless of whether they are taxable or not.

> "Inclusion of nontaxable dividends in the [section 24344] subsection (b) computation does not mean that California is taxing dividends of a foreign corporation . . . . The dividends are not being taxed. They are being used to offset or reduce the interest expense deduction, and, as pointed out above, it is not unreasonable to use investment income to offset investment expense.
>
> . . .
>
> "[¶] . . . **The apportionment of expenses to offset income from sources without the state does not mean that the out-of-state income is being taxed so long as it is not unreasonable to use the expense to offset the out-of-state income. California uses two methods to apportion the income, one for operating income and another for dividend income, and it is not unreasonable**

---

4. Since *Pacific Tel.*, the doctrine of *mobilia sequuntur personam* has been replaced by the business/nonbusiness distinction under UDIPTA. However, under both doctrines, the allocation of the dividend income here at issue to a source outside of California remains the same.

> **to view interest expense as investment expense and require that the interest expense be used to offset the investment income, the interest and dividend income. This is true whether or not the investment income is included in the measure of the California tax. Accordingly, the requirement that dividend income, whether or not included in the measure of the tax, be used to offset or reduce the interest expense deduction does not mean that the dividend income is being taxed."** [Emphasis added.] (*Pacific Telephone*, *supra*, 7 Cal.3d at p. 555, 498 P.2d at p. 1038.)

Petitioners assert that the California Supreme Court's analysis in *Pacific Telephone* is simply "California's attempt to relabel what in reality is unconstitutional taxation." (Petition, p. 15.) In fact, this analysis reflects the fundamental apportionment principle that a statute that merely apportions deductions by the measure of nontaxable income imposes neither a direct nor indirect tax on such tax exempt income. This principle has been affirmed by this Court in a number of cases. These cases essentially hold that a statute that merely correlates expenses between taxable income and nontaxable income in order to determine the allowable deduction for the purpose of determining taxable income does not result in the imposition of an impermissible tax on nontaxable income.

In *Denman v. Slayton*, 282 U.S. 514 (1931), this Court upheld the constitutionality of a federal tax statute which permitted the deduction from taxable income of interest expense on indebtedness, except as to indebtedness incurred to purchase or carry tax-exempt securities. The Court concluded that the disallowance of deduction from taxable income of interest expense on indebtedness incurred to purchase or carry tax-exempt securities did not result in the impermissible taxation of tax-exempt income.

Similarly, in *Helvering v. Independent Life Ins. Co.*, 292 U.S. 371 (1934), this Court upheld the constitutionality of federal tax provisions which allowed the deduction of depreciation and expenses of buildings owned by life insurance companies but only on the condition that the company include in its gross income the otherwise nontaxable rental value of the space which it occupied. The Court ruled that the statutory provisions did not amount to an improper tax on the tax-exempt rental value, but were simply a permissible "apportionment of expenses." (*Id.*, at p. 381.)

In *United States v. Atlas Life Ins. Co.*, 381 U.S. 233 (1965), this Court "affirm[ed] the principle announced in *Denman* and Independent Life that the tax laws may require tax-exempt income to pay its way" by upholding the pro rata deduction provisions of the Life Insurance Company Income Tax Act of 1959. Under a formula prescribed by these provisions, the taxable investment income of a company was divided between the policyholders' share, which was not taxed, and the company's share, which was taxed, and the company was permitted to deduct only its share of tax-exempt interest from gross income. The United States Supreme Court rejected the insurance company's contention that this allocation resulted in an impermissible tax on its tax-exempt municipal bond interest and that it should be permitted to deduct the full amount of its exempt interest.

In *First Nat. Bank v. Bartow Cty. Tax Assrs.*, 470 U.S. 583 (1985), this Court dealt with a state statute which imposed a tax on the property of banks calculated on the basis of the bank's net worth. In calculating net worth, a bank was not permitted under the statute to deduct the full value of tax-exempt United States obligations which it held. The United States Supreme Court held that the provision of the state statute limiting the deduction did not violate the tax-

exempt status of federal obligations, confirming its earlier rulings in *Denman*, *Independent Life*, and *Atlas Life*.

As noted above, given the impossibility of precisely attributing borrowed funds to business or nonbusiness purposes, California's interest offset rule is a rational legislative method of assigning interest expenses to business and nonbusiness sources. This California rule is consistent with this Court's affirmation of the principle that tax-exempt income may be made to bear a fair share of the burdens properly allocable to it. (*United States* v. *Atlas Life Ins. Co.* and *Denman, supra.*)

B. The Purpose And Logic Of Section 24344(b), As Analyzed In Pacific Telephone, Remain Viable.

Petitioners argue that the interest offset statute cannot be sustained as "reasonable" because the tax loophole which the California Supreme Court indicated Section 24344(b) was meant to close does not exist as a matter of law. (Petition, pp. 17-18.) They maintain that the purported "logic" of the statute (*e.g.* that it is not unreasonable to assume a connection between interest expense and investment income) fails as a matter of law. As demonstrated below, these arguments are without merit.

According to petitioners' analysis, California's "interest offset applies only to *business* interest expense (*i.e.*, expense incurred in the regular course of the taxpayer's business, as opposed to expense incurred for investments)" so "as a matter of law, the interest expense involved in interest offset does not relate to or 'match' nonbusiness dividend or investment income." (Italics in original, Petition pp. 18-19.) Petitioners' analysis is incorrect because section 24344 refers to "interest expense" not "business interest expense".

Petitioners' erroneous analysis of California's interest offset provision is based upon an apparent ambiguity in Cal. Franchise Tax Return Form 100, Schedule R-5. (See Petition, p. 18.) Citing Cal. Franchise Tax Return Form 100, Petitioners contend that the interest offset calculation requires the exclusion of any "nonbusiness interest expense" as the first step in the interest offset calculation thus suggesting that the interest offset necessarily applies only to "business interest expense". This is **not** the case, because Section 24344(b) does not require the exclusion of any "nonbusiness interest expense" as the first step. Even if the tax form suggests otherwise, it is a non-issue. It is the statute that governs the proper calculation of interest offset, not the tax return form.

In any event, as a factual matter, the potential conflict between the calculation of interest offset using the methodology prescribed by Section 24344(b) and the calculation using Cal. Franchise Tax Return Form 100 was never at issue in this case.[5/] Petitioners have never argued that the interest offset provision was improperly calculated when they used the methodology prescribed by Section

---

5. Another case involving essentially the same constitutional challenges to Section 24344(b) as those raised herein was heard by the same appellate panel, on the same day, as this case. That case is currently pending before this Court--*Hunt-Wesson, Inc. v. Franchise Tax Board*, U.S. Supreme Court No. 98 -2043, petition for writ of certiorari filed June 21, 1999). In *Hunt-Wesson*, the plaintiff specifically addressed the apparent ambiguity in Cal. Franchise Tax Return Form 100. As in this case, it was made clear to the appellate court that this was a non-issue because the parties agreed that the interest offset calculation was made in conformity with the requirements of Section 24344(b), not the tax return form, and that Section 24344(b) does not require exclusion of all "nonbusiness interest expense" as a first step. Respondent's opposition to the petition for writ of certiorari in *Hunt-Wesson* is due on August 21, 1999.

24344(b); rather they challenge the constitutionality of that methodology.

Because Section 24344(b) does not require the initial exclusion of "nonbusiness interest expense" from the interest offset computation, Petitioners' argument that as a matter of law, the interest expense involved in interest offset does not relate to or match nonbusiness dividend or investment income fails. In fact, because money remains fungible, the purpose and logic of the application of interest offset to nontaxable dividend income in order to close a potential tax loophole, as explained in *Pacific Telephone*, remains viable.

Petitioners further argue that the interest offset statute is not reasonable and contravenes the Due Process Clause because it makes no attempt to match dividend income against the interest expense incurred to produce the income. (Petition, p. 19.) Petitioners point to the fact that "some states allocate interest expense 'attributable' to nontaxable dividend income according to an apportionment formula, usually based on the ratio of nonbusiness income to total income or the ratio of nonbusiness assets to total assets." (Petition, pp. 19-20, fn. 11.)

California's interest offset statute does not require nor provide for, tracing of borrowed funds to determine whether interest expense was incurred for business or nonbusiness (investment) purposes. Given the fungible nature of money, such tracing would be administratively overburdensome and would not necessarily result in an accurate match of dividend income against interest expense incurred to produce that income.

This dilemma is part of a tax administrator's difficult task of measuring the appropriate amount of unitary business

income attributable to those members of a unitary group subject to tax in the State. As this Court has observed,

> "Allocating income among various taxing jurisdictions bears some resemblance, . . . to slicing a shadow." (*Container, supra*, 463 U.S. at p. 192.)

There is no exact, scientific way of apportioning a multi-state unitary business's interest expense between sources within California and sources without the state. Section 24344 provides a rational legislative solution to the serious administrative difficulties which Respondent would encounter if it were required to attempt to ascertain the precise purpose for which a taxpayer's interest expense was incurred. Clearly the proceeds of the loans which generated Woolworth's interest expense deductions inevitably supported the activities of the Corporate Office which conducted activities relating to both its unitary and nonunitary subsidiaries. The funds invested in the nonunitary subsidiaries in earlier years was money which, if used for business purposes, would have reduced, if not eliminated, the need to borrow during the fiscal years.

Similarly, the borrowed funds inevitably had the effect of making available other working capital for F. W. Woolworth Co. to use, either now or in future years, for the direct or indirect benefit of its nonunitary subsidiaries. These nonunitary subsidiaries generated substantial dividend income which was allocated entirely outside of California. Petitioners seek to gain a full deduction for all its interest expense including that portion which was indirectly used to generate income not taxable to California. This double tax benefit is precisely the "loophole" which section 24344(b) was intended to eliminate, as recognized by this Court in *Pacific Telephone*.

In Section 24344, the Legislature has selected one method among several methods to assign interest expense between classes of income for the purpose of determining net income. Such assignment does not result in the indirect taxation of such income but rather results in the reasonable matching of expenses to income with the taxable nature of the income dictating the deductibility of the expense. The Court of Appeal was correct in finding that although there may be other reasonable methods of treating interest expense, California's approach is a reasonable one. (Op. at p. 17.).

C. The Interest Offset Provision Does Not Contravene The Commerce Clause.

Petitioners contend that Section 24344(b) "violates the Commerce Clause prohibitions on local economic protectionism by discriminating against interstate commerce." (Petition, p. 20.) First, petitioners assert that California's intent to discriminate is clear. They rely upon statements taken out of context from the *Pacific Telephone* decision as evidence of the State's purported discriminatory intent. (Petition, p. 21.).[6/] In fact, the record in this case is

---

6. Petitioners assert that the following highlighted statement in the *Pacific Telephone* decision is clear evidence that in enacting Section 24344(b), California intended to favor domiciliary corporations and to discriminate against interstate commerce. The California Supreme Court stated:

> "A fourth reason, although perhaps not a strong one alone, for refusing to limit dividends to taxable dividends, is the phraseology of the section. It was pointed out above that as to a domiciliary corporation the subsection is not a limitation on interest expense but merely establishes a method to allocate the expense. Nevertheless the phraseology of the subsection is that of limitation, and this indicates that in some situations the subsection must act as a limitation on the

devoid of any substantial evidence to support Petitioner's contention in this regard.

Petitioners further assert that Section 24344(b) is facially discriminatory because it purportedly subjects nondomiciliary corporations involved in interstate commerce to higher tax burdens than California domiciled corporations and imposes higher tax burdens on recipients of dividend income from subsidiaries operating wholly outside California than recipients of dividend income from subsidiaries operating wholly within California. (Petition, p. 23.) Petitioners have distorted the focus of the constitutional analysis in order to frame the question to their advantage.

The pertinent focus is not the effect that interest offset has on domiciliary corporations versus nondomiciliary corporations, in isolation, but how a corporation's interest expense is attributable to business income and nonbusiness income within the overall apportioned tax scheme that is applied to a unitary business and whether there is internal

---

amount of interest expense. **The limitation view is reinforced because of a letter to former Governor Knight by the board prior to his signing the legislation before us which states that the addition of the provision before us will increase taxes on foreign corporations while reducing those of domestic corporations.** [¶] Inclusion of nontaxable dividends in the subsection (b) computation does not mean California is taxing dividends of a foreign corporation contrary to the doctrine of *mobilia sequuntur personam*. The dividends are not being taxed. They are being used to offset or reduce the interest expense deduction, and, as pointed out above, it is not unreasonable to use investment income to offset investment expense." (7 Cal. 3d at p. 535; 498 P.2d at p. 1038)

This statement alone does not constitute evidence of legislative intent to discriminate. Neither the Board letter referred to above nor the legislative history of the interest offset provision is in evidence in this case.

consistency if that scheme were applied by every jurisdiction.

The Court of Appeal addressed petitioners' Commerce Clause arguments, as follows:

> "Appellants suggest the interest offset provision favors local commerce in two ways. First, they argue that subsidiaries' income from California sources does not attract interest offset because such earnings are 'previously taxed' and therefore deductible from the tax base under Section 24402. However, because California has previously taxed the income in question, we discern no unconstitutional discrimination in the state refraining from double taxation. (See *Pacific Telephone, supra*, 7 Cal.3d at p. 548, fn.4.) Unlike *Fulton* [*Corp.* v. *Faulkner* (1996) 516 U.S. 325], *supra*, on which appellants rely, the statute does not waive an otherwise uniform intangibles tax, based simply on the percentage of the underlying corporate income taxed by the state. Instead, it operates as part of an overall apportioned tax scheme, matching expenses with income in a manner which our Supreme Court has determined to be reasonable. (*Pacific Telephone, supra*, 7 Cal.3d at pp. 551-551, 555.) Second, appellants contend California corporations are favored because their interest expense is fully deductible against their subsidiaries' dividend income. [fn omitted.] Our Supreme Court recognized this anomaly in Pacific Telephone, but upheld the statute on the theory that the interest offset does not tax the offset dividend income. [fn. omitted.] (*Supra* at p. 555.)" (Op. at pp. 20-21.)

As the Court of Appeal accurately determined, Section 24344(b) does not provide for disparate treatment of interest expense depending upon whether the taxpayer is a domiciliary or nondomiciliary corporation. It is the character of the income (i.e., business or nonbusiness) attributable to a corporation's interest expense that determines whether a corporation may fully deduct its interest expense in California, not the corporation's state of domicile. Therefore, Section 24344(b) is not facially discriminatory against interstate commerce.[7/]

California law provides for a deduction of dividends declared from income which has been "included in the measure of the taxes imposed . . . upon the taxpayer declaring the dividends." (Cal. Rev. & Tax. Code § 24402.) This deduction is intended "to avoid double taxation at the corporate level of income which has already been subjected to California taxation in the hands of the dividend-declaring corporation." (*Pacific Telephone*, *supra*, 7 Cal.3d at p. 548, fn. 4, quoting *Safeway Stores, Inc. v. Franchise Tax Board* 3 Cal.3d 745, 749-750 (1970); italics omitted.) Since the dividend-producing income has already been taxed in California, no advantage is afforded to California subsidiaries over foreign subsidiaries.

Because Section 24344(b) excludes from the operation of the interest offset any amount attributable to dividends which have been included in the measure of the taxpayer's

---

7. Petitioners rely upon *Fulton Corp.* v. *Faulkner*, 516 U.S. 325 (1996) . As the Court of Appeal observed, *Fulton* is distinguishable because the intangibles tax in *Fulton* was facially discriminatory against interstate commerce where it permitted a taxable percentage deduction equal to the percentage of the issuing corporation's income taxed by the state. California's interest offset provision is not facially discriminatory and operates as part of an apportionment formula that matches expenses with income in a reasonable manner.

taxes, neither the California domiciled corporation nor the out-of-state domiciled corporation may take those dividends into account in the calculation of interest applied under the interest offset. Thus, any amount removed from the application of the interest offset attributable to such dividends is equally removed for both. Accordingly, California domiciled corporations are not treated differently with respect to such amounts, and are afforded no advantage related to their domicile. Thus, the Court of Appeal properly relied upon the reasoning and holding in *Pacific Telephone* in rejecting the appellants' constitutional challenges to Section 24344(b).

With respect to a Commerce Clause challenge, the interest offset provision is not to be tested in isolation but must be analyzed as part of an overall taxing scheme by which Woolworth's income is apportioned pursuant to a judicially-approved formula among all of the states in which it conducts business. This Court has declared that a taxing statute applied to a unitary business is constitutionally sound if it has "what might be called internal consistency" if applied by every jurisdiction. This doctrine has been applied to statutes challenged on the grounds of facial discrimination under the Commerce Clause. (*ARMCO, INC.* v. *Hardesty* 467 U.S. 638, 644 (1984); *Tyler Pipe Inds.* v. *Dept. of Revenue* 483 U.S. 232 (1987).)

Thus, the constitutionality of Section 24344(b) is not to be tested solely on the basis of its impact on F. W. Woolworth's California tax but upon its impact upon Woolworth's collective tax liability in all of the states in which it is subject to tax. The applicable test is, if Section 24344(b) were to be applied in every state in which Woolworth is taxable, does the statute result in no less than 100 percent of Woolworth's total interest expense being recognized as a deduction against its total tax liability? Applying the internal consistency doctrine to Section

24344(b) in this case, it is evident that if California's interest offset rule was applied by every state in which Woolworth was taxable, Woolworth would recognize the full benefit of a deduction for each dollar of interest expense which it had incurred.

To the extent that Woolworth's interest expense deduction was limited (offset) in California under Section 24344(b), that amount of offset interest expense will be recognized and have the effect of reducing Woolworth's taxable income in New York, its state of domicile. This is because the interest expense which is offset in California has essentially been statutorily deemed to be attributable to the generation of nonbusiness dividend income (nonbusiness income). The corporation's nonbusiness income is taxable in its state of domicile. (Cal. Rev. & Tax. Code § 25126.) In arriving at the amount of the corporation's nonbusiness income to be taxed the corporation will be permitted to deduct the interest expense attributed to the generation of that nonbusiness income (i.e. the amount of interest expense offset in California).

In the absence of distinctive issues, the anti-discrimination principle of the Commerce Clause "has not in practice required much in addition to the requirement of fair apportionment." (*Container*, *supra*, 463 U.S. at pp. 169, 171; see *Trinova Corp. v. Michigan Treasury Dept.* 498 U.S. 358, 384-387 (1989).) That the precision by which income is apportioned to each state may be somewhat imperfect does not alone violate the Commerce Clause. (*Amerada Hess v. Director, N.J. Dept. of Treasury* 490 U.S. 66, 74 (1989).) Petitioners have failed to establish that California's tax has not been fairly apportioned.

D. The Interest Offset Provision Does Not Contravene The Equal Protection Clause.

Petitioners' Equal Protection challenge to Section 24344(b) is based upon the same skewed focus upon corporate domicile that they rely upon for their Commerce Clause arguments. As discussed above, California's interest offset provision does not treat corporations unequally solely on the basis of their state of incorporation. Multi-state corporations engaged in a unitary business, whether domiciled in California or elsewhere, are subject to the same rules for offsetting interest expense against investment income.

"[I]n taxation, even more than in other fields, legislatures possess the greatest freedom in classification." (*Madden v. Kentucky*, 309 U.S. 83, 88 (1940).) Even if discriminatory, a classification is not violative of the Equal Protection Clause if any state of facts reasonably can be conceived that would sustain it. (*Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S. 522, 528 (1959); *Western & Southern Life Ins. Co. v. State Board of Equalization*, 451 U.S. 648, 674 (1981); *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 464 (1981).) The validity of a statute has consistently been reviewed based on whatever may reasonably have been the legislative purpose and policy in adopting it. (*Allied Stores of Ohio*, *supra*, 358 U.S. at pp. 528-529.)

Section 24344(b) is rationally related to a legitimate state interest which is to close a potential tax loophole as discussed above. There is no single, scientific method of apportioning a multi-state unitary business's interest expense between sources within California and sources without the state. Section 24344 is a rational legislative solution to accomplish a legitimate objective. Clearly F.W.

Woolworth's nonunitary foreign subsidiaries generated substantial dividend income which was allocated entirely outside of California. In the absence of the interest offset provision, Petitioners would gain a full deduction for interest expense that was used to generate income not taxable to California. Section 24344(b) does not contravene the Equal Protection Clause of the United States Constitution.

CONCLUSION

Accordingly, Respondent respectfully submits that the petition for writ of certiorari should be denied.

Respectfully submitted,

BILL LOCKYER
Attorney General
TIMOTHY G. LADDISH
Senior Assistant Attorney General
RANDALL P. BORCHERDING
Supervising Deputy Attorney General
JOYCE E. HEE
Deputy Attorney General
Counsel of Record
1515 Clay Street, 20th Floor
Oakland, California 94612-1413
Telephone: (510) 622-2227
Fax No: (510) 622-2121
Counsel for Respondent

August 4, 1999.

Supreme Court, U.S.
FILED
AUG 16 1999
OFFICE OF THE CLERK

No. 98-1967

In The

Supreme Court of the United States

F. W. WOOLWORTH CO. and
KINNEY SHOE CORPORATION,

Petitioners,

v.

FRANCHISE TAX BOARD,

Respondent.

On Petition For A Writ Of Certiorari To The Court Of Appeal Of California

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

JOHN R. REESE
Counsel of Record
SIMONA S. GUREVICH
McCUTCHEN, DOYLE, BROWN & ENERSEN, LLP
Three Embarcadero Center
San Francisco, California 94111
Telephone: (415) 393-2000
Attorneys for Petitioners

August 16, 1999

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

TABLE OF CONTENTS

Page

INTRODUCTION 1

ARGUMENT 1

I. THE COURT SHOULD GRANT CERTIORARI TO DECIDE WHETHER INTEREST OFFSET VIOLATES DUE PROCESS 1

A. As A Matter Of California Statutory Law, Interest Offset Does Not Match Interest Expenses And Dividend Income From Nondomiciliaries 2

B. The Board's "Money Is Fungible" Argument Has No Place In A Constitutional Analysis .. 4

II. CERTIORARI SHOULD BE GRANTED TO DECIDE WHETHER INTEREST OFFSET VIOLATES THE COMMERCE CLAUSE 5

III. THE COURT SHOULD GRANT CERTIORARI TO DECIDE WHETHER INTEREST OFFSET VIOLATES THE EQUAL PROTECTION CLAUSE 8

IV. THE IMPORTANT QUESTIONS PRESENTED REQUIRE THIS COURT'S GUIDANCE 9

CONCLUSION 10

TABLE OF AUTHORITIES

Page

CASES

Armco, Inc. v. Hardesty, 467 U.S. 638 (1984) 7

Associated Industries v. Lohman, 511 U.S. 641 (1994) 6

Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564 (1997) 7

Container Corp. v. Franchise Tax Board, 463 U.S. 159 (1983) 7

Denman v. Slayton, 282 U.S. 514 (1931) 4

First National Bank v. Bartow County Board, 470 U.S. 583 (1985) 4

Fulton Corp. v. Faulkner, 516 U.S. 325 (1996) 7

Great Western Financial Corp. v. Franchise Tax Board, 479 P.2d 993 (Cal. 1971) 2

Helvering v. Independent Life Insurance Co., 292 U.S. 371 (1934) 3-4

Metropolitan Life Insurance Co. v. Ward, 470 U.S. 869 (1985) 9

Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175 (1995) 8

Oregon Waste Systems, Inc. v. Department of Environmental Quality, 511 U.S. 93 (1994) 6

South Central Bell Telephone Co. v. Alabama, 119 S. Ct. 1180 (U.S. 1999) 7

United States v. Atlas Life Insurance Co., 381 U.S. 233 (1965) 3-4

Western & Southern Life Insurance Co. v. State Board of Equalization, 451 U.S. 648 (1981) 9

Williams v. Vermont, 472 U.S. 14 (1985) 9

TABLE OF AUTHORITIES – Continued

Page

CONSTITUTIONAL PROVISIONS

Commerce Clause, U.S. Const. art. I, § 8, cl. 3 5-8

Due Process Clause, U.S. Const. amend. XIV, § 1 1-5

Equal Protection Clause, U.S. Const. amend. XIV, § 1.....8-9

STATUTES AND REGULATIONS

Cal. Rev. & Tax. Code § 24344..... *passim*

Cal. Rev. & Tax. Code § 24425.....2-3, 5

18 Cal. Code Reg. §§ 24344(c)(3), (4) & (5)..... 5

18 Cal. Code Reg. § 25120(d) 5

INTRODUCTION

Respondent Franchise Tax Board acknowledges that interest offset reduces a nondomiciliary's (but only a nondomiciliary's) interest expense deduction by exactly the amount of its constitutionally nontaxable income. It tries to avoid the constitutional implications of this by denying that interest offset is a tax and denying that discrimination by domicile is the proper focus of the constitutional analysis. The Board's arguments merely confirm the constitutional frailty of the statute and the need for this Court's review.

ARGUMENT

I. THE COURT SHOULD GRANT CERTIORARI TO DECIDE WHETHER INTEREST OFFSET VIOLATES DUE PROCESS

The Board concedes that "the dividends Woolworth received from its nonunitary foreign subsidiaries constituted nonbusiness dividend income that is immune from taxation by California," and that Woolworth's total interest expense deduction was "limited" by this constitutionally tax-immune income. Opp. 5, 23. And it does not deny that the net effect was the same as a direct tax on that income. Thus, the only issue is whether this satisfies due process.

To avoid the due process constraints on California's ability to reach Woolworth's dividend income, the Board argues that interest offset is a rational method of matching interest expense with the income it generates.

Opp. 14. This novel approach to due process fails to save interest offset.

A. As A Matter Of California Statutory Law, Interest Offset Does Not Match Interest Expenses And Dividend Income From Nondomiciliaries

The Board argues that interest offset is an "ordering rule" that "assigns" interest expense to the income it generates, and that "a state bears no obligation to allow a deduction for an expense *relating* to dividend income which that state is barred from taxing." Opp. 8 (emphasis added). To support this argument the Board relies on this Court's cases holding that statutorily tax-exempt income may be taxed up to its *fair* share of *related* expenses. Opp. 12-14. The Board's description of interest offset is false, and therefore its legal proposition and citations are irrelevant.

California Revenue & Taxation Code section 24425 expressly excludes from the measure of tax "any amount otherwise allowable as a deduction which is allocable to . . . income not included in the measure of the tax imposed." *See Great Western Fin. Corp. v. Franchise Tax Bd.*, 479 P.2d 993, 995-96 (Cal. 1971) (holding that section 24425 disallows deduction of expenses used to produce dividend income that is not taxable). As a result, interest offset applies only to *business* interest expense, which, by definition, is *not* related to nonunitary dividend income.

Despite its pleas to consider the "overall context" of California's tax scheme, *see, e.g.*, Opp. 7, 22, the Board fails to mention section 24425, even once. This is a telling

omission given that section 24425 does exactly what the Board contends interest offset is trying to do.

Instead, the Board attacks Woolworth's citation of a schedule to the California Franchise Tax Return – on which the tax is actually paid. According to the Board, the form is "ambiguous," and "[i]t is the statute that governs the proper calculation of interest offset" "[e]ven if the tax form suggests otherwise." Opp. 15. However, even if the statute controls, the tax form and section 24425 are in perfect harmony: both exclude "nonbusiness interest expense" from the interest offset computation.

Moreover, even if interest offset somehow did involve nonbusiness interest expense used for investment, the Board admits that the statute makes no attempt to apportion or match dividend income against the interest expense incurred to produce the income. Opp. 16 (disclaiming any attempt to trace funds). Indeed, as the Board concedes, interest offset allocates *all* of the interest expense to the constitutionally tax-immune income, *dollar-for-dollar*, until one of the two is gone, without any inquiry into whether there was any relationship between the two. Opp. 3. That is anything but apportionment.

Accordingly, the Board's reliance on the "fair share" principle is misplaced. First, the "fair share" principle has never been applied to constitutionally nontaxable (as opposed to statutorily tax-exempt) income. Pet. 19 n.11. None of the Board's four cases was a due process challenge based on a lack of nexus between the taxing body and the income taxed. Three, *United States v. Atlas Life Insurance Co.*, 381 U.S. 233, 239-40 (1965), *Helvering v.*

Independent Life Insurance Co., 292 U.S. 371, 377-78 (1934), and *Denman v. Slayton*, 282 U.S. 514, 518-19 (1931), involved a federal tax; the fourth, *First National Bank v. Bartow County Board*, 470 U.S. 583, 585-86 (1985), involved a Georgia tax of a Georgia bank's property.

Second, even if the cases were on point, they do not support the constitutionality of interest offset because each case involved a properly apportioned tax. *First National*, 470 U.S. at 593 (relying on "fair share" of burden); *Atlas Life*, 381 U.S. at 247, 251 (noting proper allocation); *Independent Life*, 292 U.S. at 380 (relying on statutory apportionment); *Denman*, 282 U.S. at 519 (finding fairly imposed tax on "just share").

In contrast, interest offset utterly fails to apportion, such that a nondomiciliary multistate company is denied a deduction of interest expenses in an amount identical to its constitutionally immune income – regardless whether 100%, 50% or 0% of its interest expense was related to generating the income. This is simply arbitrary, the opposite of the "fair share" apportionment that the Court has upheld in the past.

B. The Board's "Money Is Fungible" Argument Has No Place In A Constitutional Analysis

Forced to acknowledge that interest offset makes no attempt to match interest expense with dividend income, the Board tries to excuse the failure by arguing that "money remains fungible." Opp. 9, 16. The significance of this fungibility apparently is that California need not apportion "a multi-state unitary business's interest expense between sources within California and sources

without the state." Opp. 17. According to the Board, section 24344 is good enough for due process purposes because it is "a rational legislative solution to [ ] serious administrative difficulties." *Id.*

This rationality test is not sufficient. First, as discussed above, the effect of section 24425 makes it *not* rational to assume *any* connection between interest expense and nonbusiness dividend income.

Second, the Board's argument that "money is fungible," thus making it "administratively overburdensome" to apportion the offset, Opp. 16, is disingenuous and inconsistent with other California tax statutes and regulations. Indeed, although the Board does not acknowledge its existence, section 24425 mandates the very apportionment that the Board says is too difficult. *See also, e.g.*, 18 Cal. Code Reg. §§ 24344(c)(3), (4) & (5) (making appropriate allocation); 18 Cal. Code Reg. § 25120(d) (requiring deduction to be "fairly distribute[d]" among business and nonbusiness income).

II. CERTIORARI SHOULD BE GRANTED TO DECIDE WHETHER INTEREST OFFSET VIOLATES THE COMMERCE CLAUSE

Woolworth proved that interest offset discriminates against interstate commerce by reducing the available tax deduction only when dividends are received by non-California domiciliaries from sources operating

outside California. Pet. 6-9, 21-26. The Board cannot deny this discrimination.[1]

Instead, the Board tries to avoid the Commerce Clause violation by proclaiming that "[t]he pertinent focus is not the effect that interest offset has on domiciliary corporations versus nondomiciliary corporations . . . . " Opp. 19. In fact, that is precisely the focus for Commerce Clause purposes, as this Court has held time and again. *See, e.g., Associated Indus. v. Lohman*, 511 U.S. 641, 654 (1994) ("[W]e repeatedly have focused our Commerce Clause analysis on whether a challenged scheme is discriminatory in 'effect.' "). That should be dispositive.[2]

The Board, however, suggests that the proper focus is "whether there is internal consistency if [the challenged tax] scheme were applied by every jurisdiction." Opp. 19-20. This is not correct. First, internal consistency is

---

[1] The Board does not dispute (or even mention) the simple examples in the table on pages 7-8 of the Petition. This table clearly demonstrates the discriminatory effect of interest offset. Instead, the Board argues that interest offset "does not *provide for* disparate treatment" based on domicile, and that interest offset affects all multistate companies equally. Opp. 21-22 (emphasis added). But whether the discrimination is in the statute's terms or in its effect, the Commerce Clause violation is clear. Pet. 6-9, 21-26. Even if the statute does not say so, only domiciliaries can take advantage of the tax deduction offered by the last step of interest offset. Pet. 23-24. The deduction has nothing to do with the "character of the income." Opp. 21.

[2] Moreover, the Board's repeated reliance on the purported reasonableness of the statute is irrelevant for a Commerce Clause analysis, which subjects discriminatory taxes to "the strictest scrutiny." *Oregon Waste Sys., Inc. v. Department of Envtl. Quality*, 511 U.S. 93, 101 (1994).

not determinative of compliance with the Commerce Clause. *See Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 169 (1983) (calling internal consistency "*the first*, and again obvious, component of fairness in an apportionment formula") (italics added). A tax provision that is internally consistent thus still may violate the Commerce Clause. *Id.* at 169-70 (describing external consistency as "second and more difficult requirement" of Commerce Clause apportionment test). Indeed, the Court never even mentioned internal consistency in several recent decisions invalidating discriminatory state tax statutes. *See, e.g., South Central Bell Tel. Co. v. Franchise Tax Bd.*, 119 S. Ct. 1180 (U.S. 1999); *Camps Newfound/ Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564 (1997); *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996).

Second, interest offset fails even the internal consistency test. A tax is internally consistent only if its adoption by every state would cause "no impermissible interference with free trade." *Armco, Inc. v. Hardesty*, 467 U.S. 638, 644 (1984). If every state applied interest offset, however, interstate commerce would suffer. Multistate businesses like Woolworth would bear a much higher tax burden than would wholly intrastate businesses. As more states indirectly taxed Woolworth's nontaxable dividend income through interest offset, Woolworth would be subjected to multiple taxation of the same income, income that is properly taxable only in New York, as the Board concedes. Opp. 5.[3] An intrastate company would be

---

[3] The Board claims that New York will recognize the interest expense deduction that California denied and reduce Woolworth's New York taxable income accordingly. Opp. 23. There is no basis whatever for this assertion.

unaffected. Indeed, the clear detriment Woolworth suffers from interest offset in California would be multiplied every time another state applied the same rule. This failure of internal consistency "shows as a matter of law that [California] is attempting to take more than its fair share of taxes from the interstate transaction." *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 185 (1995).[4]

Regardless of the test used to determine whether interest offset violates the Commerce Clause, the outcome is the same. Interest offset discriminates against interstate commerce. It must be struck down.

III. THE COURT SHOULD GRANT CERTIORARI TO DECIDE WHETHER INTEREST OFFSET VIOLATES THE EQUAL PROTECTION CLAUSE

Interest offset gives domiciliaries an interest expense deduction that it denies to nondomiciliaries. Pet. 26-28. The Board neither disputes nor justifies this discrimination. Its reliance on the California Legislature's freedom to classify taxes as it sees fit is insufficient, even under rational basis review, for two reasons. The statute is not rationally related to a legitimate state interest because (1) its protectionist purpose is not legitimate, *see*

---

[4] The Board argues that internal consistency is satisfied because Woolworth would be entitled to its full interest expense deduction if every state applied interest offset. Opp. 22. That misstates the test. In fact, there is no internal consistency because Woolworth would be taxed repeatedly on more than 100% of its tax base whereas an intrastate corporation would not.

Metropolitan Life Ins. Co. v. Ward, 470 U.S. 869, 876-78 (1985), and (2) it is not rationally related to the stated purpose because the supposed "tax loophole" does not exist. *See Western & S. Life Ins. Co. v. State Bd. of Equalization*, 451 U.S. 648, 668 (1981); *Williams v. Vermont*, 472 U.S. 14, 23 (1985) (striking down tax because "[a] State may not treat those within its borders unequally solely on the basis of their different residences or States of incorporation").

The Court should grant the writ to decide whether interest offset violates the Equal Protection Clause.

IV. THE IMPORTANT QUESTIONS PRESENTED REQUIRE THIS COURT'S GUIDANCE

The parties agree on the operation and effect of interest offset – and that it takes into account constitutionally nontaxable income to increase Woolworth's franchise tax. The only dispute, ripe for this Court's review, is whether interest offset survives constitutional scrutiny.

Nevertheless, the Board says the constitutional issues "lack national import or significance." Opp. 6. But the Board does not repudiate what it told the Court of Appeal: "[t]he constitutionality of [interest offset] is of great significance to taxpayers and the state." 1/4/99 letter from Bill Lockyer, Cal. Attorney General, to Court of Appeal. The constitutionality of the statute *is* of great national significance. This Court should grant review.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

JOHN R. REESE
Counsel of Record
SIMONA S. GUREVICH
McCUTCHEN, DOYLE, BROWN & ENERSEN, LLP
Three Embarcadero Center
San Francisco, California 94111
(415) 393-2000
Attorneys for Petitioners

August 16, 1999